87-932

No.

Supreme Court, U.S.
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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1987

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J. C. BRADFORD & CO.,

*Petitioner,*

v.

SUZANNE KIRKPATRICK; DOROTHY D. CASLER; and CHARLES H. LINDSEY, on behalf of themselves and all others similarly situated,

*Respondents.*

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## PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

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## QUESTIONS PRESENTED

1. In an action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder which is sought to be maintained as a class action, can the commonality requirement of Rule 23(b)(3), Federal Rules of Civil Procedure, be satisfied by use of the so-called "fraud-on-the-market" theory where the securities were neither traded in an established market nor fraudulently issued?

The Court of Appeals answered this question affirmatively.

2. In an action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5(2), based upon oral representations, which is sought to be maintained as a class action, is the commonality requirement of Rule 23(b)(3), Federal Rules of Civil Procedure, satisfied if the record fails to demonstrate that the representations to class members were uniform?

The Court of Appeals held that since the record failed to demonstrate that the oral representations were *not* uniform, the District Court abused its discretion in ruling that the requirements of Rule 23(b)(3) had not been satisfied.

3. In a securities fraud action which is sought to be maintained as a class action, must the Court consider class certification of claims under Sections 11 and 12 of the Securities Act of 1933 if the named plaintiffs' claims under these sections have been dismissed as time barred?

The Court of Appeals ruled that the District Court abused its discretion in failing to consider class certification of such claims.

4. In an action under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, which is sought to be maintained as a class action, must the named plaintiffs be considered adequate representatives under Rule 23(a)(4) unless they virtually abdicate to their attorneys the conduct of the case?

The Court of Appeals held that since plaintiffs were represented by competent and zealous counsel, their lack of interest in the litigation would not disqualify them as class representatives, absent such virtual abdication.

## THE PARTIES

The names of the parties to the proceeding are contained in the caption.

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## PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

---

Petitioner, J. C. Bradford & Co. ("Bradford"), prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eleventh Circuit entered on September 15, 1987, in a case captioned *Kirkpatrick, et al. v. J. C. Bradford & Co.*, No. 86-8624.

## OPINIONS BELOW

The Opinion of the Court of Appeals is reported at 827 F. 2d 718 and is also reported in [Current Binder] Fed. Sec. L. Rep. (CCH) at ¶92,548; a copy of the Opinion is reproduced at Appendix A to this Petition. The Order of the United States District Court for the

Northern District of Georgia denying class certification is reported *sub. nom. Sanders v. Robinson Humphrey/American Express, Inc.* at 634 F. Supp. 1048 and is also reported in [1985-1986 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶92,880; a copy of the Order is reproduced at Appendix D to this Petition. The Opinion of the District Court denying plaintiffs' motion to reconsider the Order denying class certification is unreported, and appears at Appendix E to this Petition.

## JURISDICTION

The judgment of the Court of Appeals was entered on September 15, 1987, and the jurisdiction of this Court is invoked under 28 U.S.C. §1254(1). The Court of Appeals denied rehearing by Order entered October 21, 1987 (Appendix B); issuance of the mandate of the Court of Appeals was stayed by Orders entered November 17 and November 20, 1987 (Appendix C).

## STATUTES AND RULES INVOLVED

The statutes and rules involved in the case are Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. §78j(b) (1982) ("Section 10(b)"); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. §240.10b-5 (1987) ("Rule 10b-5"); Rule 23 of the Federal Rules of Civil Procedure; and Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§77k, 77l(2) (1982).

## STATEMENT OF THE CASE

This Petition seeks review of a judgment of the Court of Appeals for the Eleventh Circuit, reversing an Order of the United States District Court for the

Northern District of Georgia which refused to certify this action as a class action. For ease of reference in this Petition, petitioner will be referred to either as "defendant" or "Bradford", while respondents will be referred to as "plaintiffs". Citations to the Opinions of the Court of Appeals and the District Court will be by reference to pages of the Appendix where such Opinions are reproduced.

**The District Court's Opinion**

This case was considered for class certification concurrently with two similar cases against other broker/dealers, *Sanders v. Robinson Humphrey/American Express, Inc., et al.* and *Parker, et al. v. Paine Webber Group, Inc.*, which actions were also pending in the United States District Court for the Northern District of Georgia. In an Opinion dated March 28, 1986, the District Court denied class certification in all three cases. (App. D-1-38). On July 8, 1986, the District Court denied plaintiffs' motion for reconsideration but certified all three cases for interlocutory appeal under 28 U.S.C. §1292. (App. E-1).

Plaintiffs in this action originally alleged that defendant, a broker/dealer in investment securities, violated Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§77k, 77l(2); Section 10 of the Securities Exchange Act of 1934, 15 U.S.C. §78j, and Rule 10b-5 promulgated thereunder, 17 C.F.R. §240.10b-5; and various common law and statutory obligations under state law, all in connection with plaintiffs' purchases of limited partnership interests in Petro-Lewis limited partnerships. (App. D-8-9). The District Court's jurisdiction was invoked under 15 U.S.C. §77v and 15 U.S.C. §78a, and under principles of pendent jurisdiction. Prior to considering the issue

of class certification, the District Court had dismissed plaintiffs' claims against Bradford under Sections 11 and 12(2) of the Securities Act as barred by the applicable statute of limitations (App. D-8 at n. 4); no appeal was taken from such dismissal. Plaintiffs seek to represent a class comprised of all individuals who made such purchases between January 1, 1981 through February 6, 1984. (App. D-5). The Petro-Lewis interests were not traded on the open market. (App. D-28). The first basis on which the District Court denied class certification was that plaintiffs were not adequate representatives of the class as required by Rule 23(a)(4). (App. D-14-20). Plaintiffs had testified that they did not believe that Bradford intended to defraud them, and two of the plaintiffs expressed reluctance to pursue claims against the Bradford employees with whom they dealt and to whom they were closely related (plaintiff Casler's son and plaintiff Lindsey's brother). (App. D-18-20). Based on this testimony, the District Court concluded as follows:

> The plaintiffs in *Kirkpatrick* do not believe, or are unwilling to prosecute, their fraud claims. For these reasons, the plaintiffs would not fairly and adequately represent the other class members.

(App. D-20).

The second ground cited by the District Court for denying class certification was that common questions of law and fact do not predominate, as required by Rule 23(b)(3) of the Federal Rules of Civil Procedure. (App. D-20-38). The District Court specifically found that the three plaintiffs in this case acknowledged

that they did not read the prospectuses and relied entirely upon information provided by their brokers. (App. D-26 at n. 12). This meant that there was no uniformity of misrepresentations or omissions which would merit class treatment. The District Court specifically found that plaintiffs had failed to establish that the brokers had used a uniform oral "sales pitch" to Petro-Lewis investors. (App. D-25).

The District Court further ruled that common questions could not predominate because each class member would have to show individual reliance. The District Court ruled that this case primarily involves alleged misrepresentations rather than omissions, so there could be no presumption of reliance under *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L. Ed. 2d 741 (1972). (App. D-27). Plaintiffs had sought to avoid the issue of reliance by asserting a fraud-on-the-market theory. The District Court ruled that the Complaint did not state a cause of action for fraud-on-the-market.

> In the current action the plaintiffs do not allege that the securities would not have been sold had the misrepresentations not been present, nor have they shown that the securities were sold on the open market at the time of the purchases.

(App. D-28).

The District Court did not separately consider class certification of plaintiffs' dismissed claims under Sections 11 and 12(2) of the Securities Act, and also denied class certification of plaintiffs' state law claims. (App. D-34-38).

**The Court of Appeals' Opinion.**

While the Court of Appeals affirmed the District Court's denial of class certification of the plaintiffs' state law claims (App. A-12), it held that the District Court had erroneously analyzed plaintiffs' fraud-on-the-market claims (App. A-6-9), and had mischaracterized the misrepresentation claim (A-10-12), and so had incorrectly determined that individual issues predominated over common issues in connection with plaintiffs' claims under Rule 10b-5.

With respect to plaintiffs' fraud-on-the-market theory, the Court of Appeals stated as follows:

> We conclude, however, that where as here, a complaint alleges that a security not traded on the open market could not have been issued but for the fraud of the defendants, class action treatment is not precluded by the possibility that some purchases, including the named plaintiffs, might have relied on factors other than the integrity of the market.

(App. A-8). The Court of Appeals did not challenge the District Court's finding that the named plaintiffs relied *entirely* upon information furnished by their brokers.

With respect to the District Court's conclusion that the misrepresentation claims were not suited for class treatment, the Court of Appeals held as follows:

> Neither the complaints nor the deposition testimony relied upon by the District Court indicate that any oral representations to the named plaintiffs varied materially from the misleading information alleged to have been

> disseminated generally as a result of the defendants' commons schemes . . . consequently, the possibility that the named plaintiffs or other potential class members may have obtained the allegedly misleading information via their individual brokers rather than through widely distributed written information cannot transform the allegations of the complaints into claims concerning primarily questions of individual reliance.

(App. A-10). It should be noted that in so ruling, the Court of Appeals did not dispute the District Court's characterization of the evidence as failing to demonstrate an *absence* of material variation in representations to class members.

The Court of Appeals also concluded that the District Court erred in failing to consider separately the appropriateness of class certification of claims under Sections 11 and 12(2) of the Securities Act, even though all such claims against Bradford had already been dismissed. (App. A-12-13).

Finally, the Court of Appeals held that the Court had applied an erroneous standard in determining that the named plaintiffs would not be adequate class representatives. (App. A-13-17). The Court of Appeals remanded the issue to the District Court for a further factual determination to be based upon the standard articulated by the Court of Appeals. It stated this standard as follows:

> We conclude, however, that in securities cases such as these, where the class is represented by competent and zealous counsel, class certification should not be denied simply

> because of a perceived lack of subjective interest on the part of the named plaintiffs unless their participation is so minimal that they virtually have abdicated to their attorneys the conduct of the case.

(App. A-16).

While other issues were dealt with by the District Court and the Court of Appeals, the foregoing is sufficient to permit this Court to conclude whether the decision by the Court of Appeals merits review.

## REASONS FOR GRANTING THE WRIT

Under Rule 17.1 of the Rules of this Court, grounds for considering review on Writ of Certiorari include a decision by the Court of Appeals which is in conflict with the decisions of another federal Court of Appeals on the same matters; or which represents such a departure from the accepted and usual course of judicial proceedings as to call for exercise of this Court's power of supervision; or which decides a federal question in a way in conflict with applicable decisions of this Court. The decision of the Court of Appeals meets all three criteria.

**1. The Court of Appeals' use of the fraud-on-the-market theory to supply the commonality requirement of Rule 23(b)(3) where the securities were neither traded on an efficient market nor fraudulently issued conflicts with many opinions of other Courts of Appeal which have interpreted and applied this theory.**

In holding that the fraud-on-the-market theory may dispense with reliance as an element of recovery in an action under Rule 10b-5 with respect to securities not traded on an open market, the Court of Appeals purported to follow the Fifth Circuit's holding in *Sho-*

*res v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*in banc*), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722, 74 L. Ed. 2d 949 (1983). Other Circuit Courts' opinions have stated that an efficient market is one of the elements which must be established in order for this theory to apply. In *Basic v. Levinson*, 786 F.2d 741 (6th Cir. 1986), *cert. granted*, 107 S. Ct. 1284 (1987), recently argued before this Court, the Sixth Circuit Court of Appeals listed an efficient market as one of five requirements for establishing a presumption of reliance under a fraud-on-the-market theory, and stated that a defendant can defeat the presumption by rebutting any of the five elements. 786 F.2d at 750, n. 6. *Levinson* assertedly involved an efficient market. Similarly, *Blackie v. Barrack*, 524 F.2d 891, 906 (9th Cir. 1975), *cert. denied*, 429 U.S. 816, 97 S. Ct. 57, 50 L. Ed. 2d 75 (1976), held that a defendant could rebut the presumption of reliance by establishing that "an insufficient number of traders relied to [distort] the price." 524 F.2d at 906. *See also Vervaecke v. Chiles, Heider & Co., Inc.*, 578 F.2d 713 (8th Cir. 1978) (reliance a necessary element for recovery in action for purchase of unregistered municipal bonds); *Ross v. A.H. Robbins*, 607 F.2d 545, 553, *cert. denied*, 446 U.S. 946 (1980) (2d Cir. 1979) (reliance may be presumed where "the material misrepresentation effected the price of stock traded on an open market"); *Penzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), vacated as moot *sub nom. Price Waterhouse v. Penzirer*, 459 U.S. 1027, 103 S. Ct. 434, 74 L. Ed. 2d 594 (1982) (investor may rely generally on the supposition that fraud has not affected the market price); *Peil v. Speiser*, 806 F.2d 1154 at 1161, n.10 (3d Cir. 1986) (fraud-on-the-market theory is based on assumption that "there is a nearly perfect market in informa-

tion"). Commentators have criticized the extension of the fraud-on-the-market theory to permit recovery in the absence of an efficient market. See, e.g., Note, *The Fraud-on-the-Market Theory*, 95 Harv. L. Rev. 1143, 1161 (1982).

The Fifth Circuit in *Shores* applied the fraud-on-the-market theory to municipal bonds not traded on the open market where the securities were "fraudulently created", 647 F.2d at 472. Defendants had induced "the Town of Frisco City to create an Industrial Development Board to finance [a corporation's] facility as a scheme to defraud the investing public", 647 F.2d at 465. The Court ruled that the plaintiff need not show that he read or relied upon the allegedly fraudulent Offering Circular issued in connection with these fraudulently created bonds in order to recover under subsections (1) and (3) of Rule 10b-5, because

> [r]ather than containing the entire fraud, the Offering Circular was assertedly only one step in the course of an elaborate scheme.

647 F.2d at 468. In this situation, the Court reasoned, it is unnecessary to establish a causal link (reliance) between the misrepresentations and the plaintiff's losses.

> Whenever the rule 10b-5 issue shifts from misrepresentation or omission in a document to fraud on a broader scale, the search for causation must shift also. The 'reliance' that produces causation in the latter type of case cannot come from reading a document. It may arise from . . . a claim from a bond buyer that he relied on the market *to provide se-*

> *curities that were not fraudulently created as we have here.*

647 F.2d at 472. (Emphasis supplied.) In *T.J. Raney & Sons v. Fort Cobb, Okl. Irr. Fuel,* 717 F.2d 1330 (10th Cir. 1983), *cert. denied,* 465 U.S. 1026 (1984) the Tenth Circuit followed *Shores* where bonds *were issued* in violation of Oklahoma law.

In the case at bar, as distinct from *Shores* and *Raney,* it is not alleged that the securities were "fraudulently created" or illegally issued, or that there was any fraud other than misrepresentations of information, the activity proscribed by subsection (2) of Rule 10b-5. The Eleventh Circuit characterized the plaintiffs' allegations as being solely that the defendant

> knowingly or recklessly participated with Petro-Lewis in disseminating materially misleading information regarding Petro-Lewis' financial condition and failed to provide other information that would have made the statements not misleading.

(App. A-3). While the Fifth and Tenth Circuits' version of fraud-on-the-market dispenses with the necessity of an established market where the securities themselves are fraudulently created, the Eleventh Circuit's version of fraud-on-the-market requires neither element. Every securities fraud case involving misrepresentations or omissions will involve this kind of "fraud-on-the-market". The conflict between the Eleventh Circuit's opinion in the case at bar and the Fifth Circuit's opinion in *Shores v. Sklar* is strikingly and ironically illustrated by the Eleventh Circuit's interchangeable use of the words "issued" and "mar-

keted" in discussing why it believed its opinion was consistent with *Shores*:

> Under *Shores*, reliance may be established by proof that securities not traded on the open market *could not have been issued* but for a fraudulent scheme by the defendants. [Citations omitted.] Here, consistent with *Shores*, plaintiffs alleged that the Petro-Lewis shares, which were not traded on the open market, *could not have been marketed* but for the defendants' fraud.

(App. A-6-7; emphasis supplied). Securities which are fraudulently marketed are not necessarily fraudulently issued. Fraudulent marketing in the 10b-5 context involves fraudulent misrepresentations or omissions, the activity proscribed by Rule 10b-5(2). Fraudulent issuance of securities involves fraud apart from misrepresentations or omissions, and is covered by subsections (1) and (3), not subsection (2). In effect, the Eleventh Circuit has extended fraud-on-the-market to cover actions for misrepresentation under Rule 10b-5(2). In *Finkel v. Docutel/Olivetti Corp.*, 817 F.2d 356, 363 (5th Cir. 1987) n. 18, the Fifth Circuit expressly disagreed with the Eleventh Circuit's position on this point as first suggested in *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 1132, 105 S.Ct. 814 (1985) *Lipton* involved securities traded on an established market.

The Eleventh Circuit's opinion in this case thus presents this Court with an opportunity to resolve the conflicts between three distinct and conflicting versions of the fraud-on-the-market theory as applied in the various Circuits. While this Court may resolve

this conflict by its disposition of *Basic v. Levinson*, unless it entirely vitiates fraud-on-the-market as a theory of recovery, it should take the opportunity to clarify how—if at all—the theory may be applied to securities not traded on an open market.

**2. The Court of Appeals' ruling that common issues predominated with respect to the alleged oral misrepresentations, without requiring a showing that such misrepresentations were identical or at least similar, conflicts with the holdings of the Fifth Circuit Court of Appeals and numerous District Court opinions from other Circuits.**

In addition to its ruling on fraud-on-the-market, the Court of Appeals concluded that the District Court had improperly found that plaintiffs' 10b-5(2) oral misrepresentation claims were unsuited for class treatment. The Court of Appeals' sole basis for reversing the District Court on this issue was its assertion that neither the complaint nor the deposition testimony relied upon by the District Court "indicate that any oral representations to the named plaintiffs varied materially from the misleading information alleged to have been disseminated generally as a result of the defendants' common schemes." (App. A-10). The Court of Appeals did not question the District Court's finding that

> the plaintiffs have presented no materials whatsoever, developed through discovery or asserted by the individual plaintiffs, indicating a uniform 'sales pitch' by the defendants to all members of the proposed classes.

(App. D-25). The Court of Appeals simply assumed that in the absence of proof that there was *not* a uniform sales pitch, the plaintiffs' allegations that

there was a uniform sales pitch could be taken as established for purposes of Rule 23(b)(3).

This holding by the Court of Appeals directly conflicts with holdings by the Fifth Circuit Court of Appeals in *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880, 882-883 (1973) and *Grainger v. State Sec. Life Ins. Co.*, 547 F.2d 303, 307 (1977), *cert. denied*, 436 U.S. 932 (1978). As pointed out above in *Simon*, Rule 23(b)(3) permits a class action only when the court affirmatively finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members; thus the party which seeks class certification has the burden of establishing such predominance.

> Even if plaintiff had established that the alleged misrepresentations were primarily written, a class action would not be appropriate unless he could prove the similarity of the writings. His failure to prove any standardized representations by Merrill Lynch bars a class action whether it is based on Rule 10b-5 or the state common law.

482 F.2d at 880. Similarly, in *Grainger*, the Court of Appeals stated as follows:

> It is possible, although unlikely, that oral misrepresentations can be uniform, e.g., through use of a standardized sales pitch by all the company's salesmen. Plaintiffs in the present case should be given the opportunity to demonstrate the existence and use of such a device. If plaintiffs cannot do this, then the District Court may quite properly refuse to

> certify a class on the grounds that common questions of law or fact do not predominate.

547 F.2d 307-308.

By reversing the District Court because of the failure of the evidence to show that there *was* material variation in the oral representations made to class members, the Eleventh Circuit did not question the District Court's finding that plaintiffs had failed to demonstrate any uniform sales pitch by Bradford. The Eleventh Circuit's opinion thus has adopted a test of commonality under Rule 23(b)(3) which is fundamentally and radically different from that followed in the Fifth Circuit. Numerous district court opinions have heretofore assumed that class certification must be denied in an oral misrepresentations case because there was no basis for a finding that the representations to different class members would be similar. See, e.g., *Moscarelli v. Stamm*, 288 F. Supp. 453, 462-463 (E.D.N.Y. 1968) (while oral statements by brokers may have been similar with respect to each class member, they could not have been standardized in the sense that written prospectuses or other documents are standardized, and class certification must be denied); *Crasto v. Estate of Kaskel*, 63 F.R.D. 18, 23 (S.D.N.Y. 1974) (even though variations in written materials can be accommodated by subclasses, class certification must be denied where action was based, at least in part, on oral misrepresentations); *McMerty v. Burtness*, 72 F.R.D. 450, 455 (D. Minn. 1976) (mixed oral and written misrepresentations required application of general rule that oral representations are not suitable for class treatment); *In re Scientific Control Corp. Securities Lit.*, 71 F.R.D. 491 (S.D.N.Y. 1976) (class treatment denied with respect to claims

involving mixed oral and written misrepresentations). The Eleventh Circuit's holding literally dispenses with the necessity of any finding that misrepresentations to different class members were similar or identical, and assumes that the requirements of Rule 23(b)(3) are met absent a showing to the contrary.

**3. In ruling that the District Court must consider class certification of claims under Sections 11 and 12(2) of the Securities Act of 1933, when all of the plaintiffs' claims under such Sections were time-barred, the Court of Appeals radically departed from the usual course of judicial proceedings, and such ruling is in conflict with opinions of this and other courts.**

In the case at bar, plaintiffs' claims under Sections 11 and 12(2) of the Securities Act of 1933 had been dismissed by the District Court as barred by the applicable statute of limitations prior to the District Court's ruling on class certification. (App. D-8 at n. 4). Plaintiffs did not seek any appeal from this ruling. The Court of Appeals, nonetheless, ruled that the District Court erred in failing to consider class certification of these claims. (App. A-12-13).

As this Court has repeatedly held, a class representative must be part of the class and "possess the same interests and suffer the same injury" as the class members. *East Texas Motor Freight v. Rodriguez*, 431 U.S. 395, 403, 97 S. Ct. 1891, 52 L. Ed. 2d 453 (1977). In *Vervaecke v. Chiles, Heider & Co., Inc., supra*, at 719, the Eighth Circuit Court of Appeals affirmed the District Court's refusal to certify an action for class treatment of claims brought under Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 where the Court had made its determination "on a record which showed that

plaintiff could not recover on his individual claim." The Opinion of the Eleventh Circuit in the case at bar obviously conflicts with both this Court's holding in *East Texas Motor Freight* and with the Eighth Circuit's holding in *Vervaecke*. Coupled with the Court of Appeals' ruling as to the appropriate standard for adequacy of representation under Rule 23(a)(4) (discussed in the next section), its holding opens grand new vistas for abuse of the class certification process. This Court should not countenance such a departure from the ordinary and usual course of judicial proceedings.

**4. The standard announced by the Court of Appeals for adequacy of representation under Rule 23(a)(4) of the Federal Rules of Civil Procedure represents such a departure from the usual and ordinary course of judicial proceedings as to call for the exercise of this Court's supervisory powers.**

The District Court expressly found, and the Court of Appeals did not question, that plaintiffs would not adequately represent the interests of other class members because

> the plaintiffs in *Kirkpatrick do not believe, or are unwilling to prosecute their fraud claims.*

(App. D-20; emphasis supplied). The Court of Appeals ruled that the District Court had applied an improper standard.

> Contrary to the district court's approach to the issue, adequate class representation generally does not require that the named plaintiffs demonstrate to any particular de-

> gree that individually they will pursue with vigor the legal claims of the class.
>
> * * *
>
> We conclude, however, that in securities cases such as these, where the class is represented by competent and zealous counsel, class certification should not be denied simply because of a perceived lack of subjective interest on the part of the named plaintiffs unless their participation is so minimal that they virtually have abdicated to their attorneys the conduct of the case.

(App. A-15-17). It should be recalled that the District Court supported its finding by quoting from each of the three plaintiffs' depositions, in which all three stated that they did not believe anyone at Bradford was guilty of fraud; further, the plaintiffs Casler and Lindsey testified to a reluctance to involve in litigation the Bradford employees (Lindsey's brother and Casler's son) who sold them the securities. The ruling by the Court of Appeals assumes that an attorney—rather than his client—ultimately controls the lawsuit. Regardless of the ethical difficulties inherent in this view, it flies directly in the face of this Court's Opinion in *Hansberry v. Lee*, 311 U.S. 32, 45, 61 S. Ct. 115, 85 L. Ed. 22 (1940):

> Such a selection of representatives for purposes of litigation, whose substantial interests are not necessarily or even probably the same as those whom they are deemed to represent, does not afford that protection to absent parties which due process requires.

## CONCLUSION

For all of the foregoing reasons, a Writ of Certiorari should issue to the United States Court of Appeals for the Eleventh Circuit.

Dated: Nashville, Tennessee
December 7, 1987

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Suzanne KIRKPATRICK; Dorothy D. Casler and Charles H. Lindsey, on behalf of themselves and all others similarly situated,

*Plaintiffs-Appellants,*

v.

J.C. BRADFORD & CO.,

*Defendant-Appellee.*

Glenn T. SANDERS on behalf of himself and all others similarly situated, and Leslie D. Sanders,

*Plaintiffs-Appellants,*

v.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., and Shearson/American Express, Inc.,

*Defendants-Appellees.*

Tommy E. PARKER, as custodian for Kimberly M. PARKER and James L. Smith, on behalf of themselves and all others similarly situated,

*Plaintiffs-Appellants,*

v.

PAINE WEBBER GROUP, INC.,

*Defendant-Appellee.*

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Nos. 86-8624 to 86-8626.

United States Court of Appeals,
Eleventh Circuit.

Sept. 15, 1987.

Appeals from the United States District Court for the Northern District of Georgia.

Before VANCE and KRAVITCH, Circuit Judges, and BROWN*, Senior Circuit Judge.

KRAVITCH, Circuit Judge:

Plaintiffs in these companion cases filed certified interlocutory appeals pursuant to 28 U.S.C. § 1292(b) challenging the district court's denial of class certification under Rule 23 of the Federal Rules of Civil Procedure. The district court denied class certification in each case on the alternative grounds that the named plaintiffs were not adequate class representatives as required by Fed.R.Civ.P. 23(a)(4) and that individual questions of fact predominated over common questions of law and fact in contravention of Fed.R.Civ.P. 23(b)(3). Concluding that the district court applied erroneous legal standards, we reverse and remand for further consideration.

## I. BACKGROUND

These are a few of the many cases arising out of the virtual collapse in 1984 of the Petro-Lewis oil and natural gas investment funds. From 1970 to 1984, about 180,000 people purchased more than $3 billion worth of Petro-Lewis securities and limited partnerships. When the price of oil and gas declined in 1981 and 1982, Petro-Lewis began borrowing funds to pay partnership distributions, to service its debt, and to promote the sale of additional programs. In February 1984, revealing for the first time that it was in dire financial straits, Petro-Lewis announced that it would implement a series of drastic economy measures, including cutting partnership distributions by as much as 50 per cent and selling between one quarter and one third of its reserves. Numerous lawsuits followed.

In *In re Petro-Lewis Securities Litigation*, [1984-85 Transfer Binder], Fed.Sec.L.Rep. ¶ 91,899 (D.Colo.1984), the U.S. District Court for the district of Colorado approved a settlement of eleven

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* Honorable John R. Brown, Senior U.S. Circuit Judge for the Fifth Circuit, sitting by designation.

consolidated class suits brought under various provisions of the federal securities laws against the directors and certain corporate entities of the Petro-Lewis organization. Under the terms of the settlement, the participating class members agreed to release the defendants and all Petro-Lewis subsidiaries in return for the formation of a royalty trust and a settlement fund valued at $23.5 million. The settlement agreement expressly provided that the plaintiff class members retained the right to file suit against any nondefendants, including broker-dealers of Petro-Lewis securities and limited partnerships.

In these cases, plaintiffs allege that the actions of the defendant brokerage firms and individuals in selling and promoting interests in Petro-Lewis violated sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*(2), section 10 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5, and various common law and statutory obligations under state law.[1] Claiming to represent classes of plaintiffs who, between January 1, 1981 to February 6, 1984, purchased, reinvested in, or otherwise acquired Petro-Lewis limited partnership interests from the defendant firms, the plaintiffs alleged that the defendants knowingly or recklessly participated with Petro-Lewis in disseminating materially misleading information regarding Petro-Lewis' financial condition and failed to provide other information that would have made the statements not misleading.

After discovery and hearings, the district court issued an order and an amended order denying certification of the classes under Rule 23 of the Federal Rules of Civil Procedure. Although the court determined that each suit satisfied the class action prerequisites of Fed.R. 23(a)(1), (2), and (3), the court denied certification on the ground that the named plaintiffs were not adequate class representatives as required by Rule 23(a)(4). The basis for this determination was that the named plaintiffs did not

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[1] Additional claims were asserted in some of the complaints. The district court's ruling on these other claims were not challenged on appeal. Accordingly, the district court's denial of class certification as to those claims will not be disturbed.

demonstrate that they would pursue the litigation with sufficient vigor to protect the interests of the class. As an alternative ground of decision, the court held that individual questions of law and fact outweighed common questions and thus that the actions did not satisfy the standards of Rule 23(b)(3). Concluding that its ruling was based upon determinations of law as to which there may be substantial ground for difference of opinion and that an immediate appeal from the denial of class certification would materially advance the ultimate determination of the actions, the court certified its order for an interlocutory appeal pursuant to 28 U.S.C. § 1292(b). We accepted jurisdiction. *See id.*

## II. RULE 23(b)(3): PREDOMINANCE OF COMMON OR INDIVIDUAL QUESTIONS

The district court's conclusion that individual questions predominate over common questions is based directly on the court's interpretation of the substance of the plaintiffs' claims. Consequently, we will consider first that aspect of the court's denial of class certification.

In holding that certification was improper under Rule 23(b)(3),[1] the court concluded that common questions of law and fact in the 10(b) and 10b-5 claims were dominated by individual questions of reliance on the part of the particular

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[1] A suit may be maintained as a class action only if the four prerequisites of Rule 23(a) are satisfied and, in addition, the case satisfies one of the requirements of Rule 23(b). *See* Fed.R.Civ.P. 23(b). In this case, there is no dispute that subsections (1) and (2) of Rule 23(b) do not apply. Rule 23(b)(3) permits class action treatment if:

> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

purchasers, statutes of limitations in each state in which there may be class members, and arbitration agreements in many of the purchase contracts. The court viewed the state law claims to be inappropriate for class action treatment because liability would depend upon the substantive law of the different states. Finally, the court refused to consider certifying classes limited to the section 11 and 12(2) claims after concluding that the 10(b) and state law claims were the dominant claims asserted in the complaints.

### A. *Section 10(b) and Rule 10b-5*

The complaints allege that the defendants violated section 10(b) and Rule 10b-5 by engaging in two related but different courses of conduct. First, the complaints contend that the defendants participated with Petro-Lewis in disseminating misleading prospectuses and in engaging in a standardized promotion by the individual brokers. Second, the plaintiffs claim that the firms continued to sell and promote Petro-Lewis shares despite the firms' awareness or reckless disregard of Petro-Lewis' severe financial difficulties. Based on these allegations, the plaintiffs assert three theories of liability under which common issues of law and fact necessarily would outweigh individual issues. They first contend that their claims concern primarily acts of omission and thus that reliance on the part of individual purchasers should be presumed under the rule of *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S.Ct. 1456, 31 L.Ed.2d 741 (1975). Second, they argue that the claims fall under the fraud-on-the-market theory adopted by our predecessor court in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. May 1981) (en banc), *cert. denied*, 459 U.S. 1102, 103 S.Ct. 722, 74 L.Ed.2d 949 (1983).[3] Finally, they argue that the allegations involve a common course of conduct toward all defendants, and thus that any issues of individual reliance could not predominate over common questions of facts. *See e.g., Kennedy v. Tallant*, 710 F.2d 711 (11th Cir. 1983).

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[3] The Eleventh Circuit, in the en banc decision *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir.1981), adopted as precedent decisions of the former Fifth Circuit rendered prior to October 1, 1981.

The district court rejected each of these theories. The court found the characterization of the claims as involving primarily omissions to be precluded by the interpretation in *Huddleston v. Herman & McLean*, 640 F.2d 534 (5th Cir. Unit A March 1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375, 103 S.Ct. 683, 74 L.Ed.2d 548 (1983), and *Cavalier Carpets v. Caylor*, 746 F.2d 749 (11th Cir.1984), of the requirements for an omissions case under *Affiliated Ute*. The court rejected the fraud-on-the-market theory as insufficiently supported by the pleadings or the evidence proffered by the plaintiffs. Finally, the court refused class action treatment under the course of conduct theory based on the court's determination that the plaintiffs' allegations involve primarily individualized oral representations rather than a common scheme by the defendants toward the plaintiff purchasers.

We agree with the district court that under the precedent of this circuit the plaintiffs' complaints cannot be properly characterized as omissions cases under the standards of *Affiliated Ute*. Here, as in *Cavalier Carpets*, *supra*, and *Huddleston*, *supra*, the complaints indicate that "[t]he defendants did not stand mute in the face of a duty to disclose as did the defendants in *Affiliated Ute*." *Cavalier Carpet*, 746 F.2d at 749 n. 22 (*quoting Huddleston*, 640 F.2d at 548). Rather, as in those cases, the allegations contend that the defendants "undertook . . . to disclose relevant information . . . now alleged to contain certain misstatements of fact and to fail to contain other facts necessary to make the statements made, in light of the circumstances, not misleading." *Id.* Consequently, the district court properly concluded that the complaints at most allege mixed claims of misrepresentations and omissions and thus that *Affiliated Ute*'s presumption of reliance does not apply.

We cannot agree, however, with the court's rejection of the fraud-on-the-market theory as a basis for class action treatment. In *Shores v. Sklar*, *supra*, the former Fifth Circuit sitting en banc held that, in fraud claims asserted under Rules 10b-5(1) and (3), the reliance element of Rule 10b-5 may be satisfied by proof that the plaintiff relied on the integrity of the market rather than on specific misrepresentations by the defendants. Under *Shores*,

reliance may be established by proof that securities not traded on the open market could not have been issued but for a fraudulent scheme by the defendants. 647 F.2d at 469; *cf. Lipton v. Documation, Inc.*, 734 F.2d 740, 747 (11th Cir.1984), *cert. denied*, 469 U.S. 1132, 105 S.Ct. 814, 83 L.Ed.2d 807 (1985) (adopting fraud-on-the-market theory in context of securities traded in open market). Here, consistent with *Shores*, plaintiffs alleged that the Petro-Lewis shares, which were not traded on the open market, could not have been marketed but for the defendants' fraud.

In rejecting this claim as improper for class treatment, the court relied solely on its conclusion that the plaintiffs' allegations lacked evidentiary support. Despite the court's assertions to the contrary, this determination was an inappropriate inquiry into the merits of the plaintiffs' claims. Certainly, as the court noted in its order, a court may look beyond the allegations of the complaint in determining whether a motion for class certification should be granted. *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147, 160, 102 S.Ct. 2364, 2372, 72 L.Ed.2d 740 (1982); *Love v. Turlington*, 733 F.2d 1562, 1564 (11th Cir.1984). Indeed, it is often necessary for a district court to consider, for example, a deposition of a named plaintiff to determine whether Rule 23(a)'s commonality and typicality requirements are met. *See, e.g., Falcon, supra; Nelson v. U.S. Steel Corp.*, 709 F.2d 675, 679-80 (11th Cir.1983). Here, however, the court's rejection of the fraud-on-the-market theory was based upon nothing other than the court's assessment of the plaintiffs' likelihood of success on the claims. This is an improper basis for deciding the propriety of a class action. *E.g., Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177-78, 94 S.Ct. 2140, 2152-53, 40 L.Ed.2d 732 (1974); *Nelson*, 709 F.2d at 679.

Nor can the court's rejection of the fraud-on-the-market theory be upheld under the rationale that fraud-on-the-market claims are improper for class treatment where, as here, the evidence indicates that the named plaintiffs relied on the advice of their brokers rather than solely on the integrity of the market. As the defendants note, several district courts have denied class certification for fraud-on-the-market claims where

evidence indicates that the named plaintiffs may in fact have relied on factors other than the market's integrity. These cases, however, generally have concerned fraud-on-the-market claims involving securities traded in an open market. *See Masri v. Wakefield*, 106 F.R.D. 322, 325 (D.Colo.1984); *Seiler v. E.F. Hutton & Co.*, 102 F.R.D. 880, 890 (D.N.J.1984); *McNichols v. Loeb Rhoades*, 97 F.R.D. 331, 334 (N.D.Ill.1982). *But see Shores v. Sklar*, [current] Fed.Sec.L.Rep. (CCH) ¶ 92,874 (N.D.Ala. July 30, 1986) (on remand, denying class certification of fraud-on-the-market claim involving security not openly traded). That version of the fraud-on-the-market theory focuses on the plaintiffs' reliance on the integrity of an open and developed market to set a price accurately reflecting the security's value. *See Lipton v. Documation*, 734 F.2d at 743. The issue of reliance on an open market thus turns on a matter of degree--the price of the security--and not, as in *Shores*, the absolute question of whether the security was worthy of being issued.

Because the Petro-Lewis shares were not traded on the open market, we need not now consider the appropriateness of class certification of traditional fraud-on-the-market claims involving securities that are openly traded. We conclude, however, that where as here, a complaint alleges that a security not traded on the open market could not have been issued but for the fraud of the defendants, class action treatment is not precluded by the possibility that some purchasers, including the named plaintiffs, might have relied on factors other than the integrity of the market.

*Shores* did not hold, as the defendants contend, that recovery is possible under a fraud-on-the-market claim only when a claimant proves reliance on the integrity of the market to the exclusion of all other factors. Rather, *Shores* was based on the premise that "[t]he securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the marketplace." 647 F.2d at 471. Consequently, where a security could not have been issued but for a fraudulent scheme, the fact that the investor may have relied on other factors in deciding to purchase that security at a particular price does not minimize the essential fact that the purchaser relied on the market's integrity to

ensure that the security was worthy of being issued. Indeed, as the court noted in *Shores*, under a theory that the defendants' fraud caused securities to be issued, "it would have availed [the plaintiff] nothing to have read the [allegedly misleading] Offering Circular." *Id.* at 470-71. A *Shores* fraud-on-the-market claim thus is especially suited for class action treatment, as it makes virtually irrelevant the possibility that the various purchasers may have relied on different representations regarding the desirability of the particular security in question: all have relied on the integrity of the market in the but-for sense required by *Shores*.*

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* In remanding to the district court, *Shores* instructed the court to "reconsider the maintainability of this action as a class action as to members of a properly defined class of Bond purchasers who did not . . . rely [on the allegedly misrepresentative offering circular]." 647 F.2d at 472. This instruction should not be misconstrued as an indication that the fraud-on-the-market claim would be available only to those individuals who did not rely on the circular. The district court previously had determined that a Rule 10b-5(2) misrepresentation claim could be brought as a class action on behalf of a class of purchasers who had relied on the offering circular. The court of appeals recognized that any member of a class so defined necessarily would satisfy one of the elements of a 10b-5(2) claim and thus could recover if it were proven on a class-wide basis that the defendants knowingly made materially misleading statements in the offering circular and that the purchasers suffered losses as a result. *See* 647 F.2d at 468 (listing elements of 10b-5(2) misrepresentation claim). The court realized that, under the facts alleged in that case, these class-wide 10b-5(2) issues would be contained in the proof necessary for recovery under the 10b-5(1) and (3) fraud-on-the-market theory. *See* 647 F.2d at 468 ("[T]he Offering Circular was assertedly only one step in the course of an elaborate scheme."). Those purchasers who did not rely could recover, however, only by meeting the additional burden of proving, under the fraud-on-the-market theory, that the securities could not have been issued but for the fraud of the defendants. Thus, the instruction that the district court determine the maintainability of a separate class for purchasers who did not rely was based simply upon the recognition that, as a practical matter, those purchasers would have a greater factual burden to establish liability than would those who relied on the offering circular. The instruction did not imply, however, that those who had relied on the offering circular could not also recover under the fraud-on-the-market theory. To the extent that the district court on remand reached a different conclusion, *see Shores v. Sklar*, [current] Fed.Sec.L.Rep. (CCH) ¶ 92,074 (N.D.Ala. July 30, 1986), we reject that court's interpretation of the en banc decision.

We conclude for similar reasons that the district court also improperly found that the plaintiffs' 10b-5(2) misrepresentation claims were not suited for class treatment. The basis for the court's denial of class certification of the misrepresentation claims was the court's conclusion that the claims involved primarily oral representations and thus would present individual issues of reliance. To arrive at this conclusion, the court focused on deposition evidence indicating that the named plaintiffs relied not so much on prospectuses and other written materials as on the recommendations of their individual brokers. The court further found that the plaintiffs had uncovered no evidence to show that their particular brokers had attended the Petro-Lewis sales sessions or explicitly followed the standardized sales pitch.

Contrary to the court's construction of the claims, however, the complaints alleged that the defendant brokerage firms and individual officers engaged in a common course of conduct to misrepresent, by affirmative acts and by omission, the financial condition of Petro-Lewis. *See, e.g., Kennedy v. Tallant*, 710 F.2d at 711. Neither the complaints nor the deposition testimony relied upon by the district court indicate that any oral representations to the named plaintiffs varied materially from the misleading information alleged to have been disseminated generally as a result of the defendants' common schemes. *See id.; cf. Simon v. Merrill Lynch, Pierce, Fennner and Smith, Inc.*, 482 F.2d 880, 883 (5th Cir.1973) ("If there is any material variation in the representations made or in the degrees of reliance thereupon, a fraud case may be unsuited for treatment as a class action."). Consequently, the possibility that the named plaintiffs or other potential class members may have obtained the allegedly misleading information via their individual brokers rather than through widely distributed written information cannot transform the allegations of the complaints into claims concerning primarily questions of individual reliance. The claims essentially involve allegations that the defendants "committed the same unlawful acts in the same method against the entire class." *Kennedy v. Tallant*, 710 F.2d at 717.

As in any 10b-5(2) misrepresentation claim, each potential class member must prove reliance on some form of the allegedly

misleading information in order to recover. *See, e.g., Shores v. Sklar*, 647 F.2d at 468. In view of the overwhelming number of common factual and legal issues presented by plaintiffs' misrepresentation claims, however, the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment. Here, as in *Kennedy v. Tallant*, each of the complaints alleges "a single conspiracy and fraudulent scheme against a large number of individuals" and thus is "particularly appropriate for class action." 710 F.2d at 718. Moreover, given the numerous and substantial common issues presented by both the fraud-on-the-market and the misrepresentation claims, the common questions in these cases cannot legitimately be considered subordinate to the individual questions presented by the different state statutes of limitations that may be applicable or by the arbitration agreements contained in some of the purchasers' contracts.[5] "Rule 23 does not require that all the questions of law and fact raised by the dispute be common." *Cox v. American Cast Iron Pipe Co.*, 784 F.2d 1546, 1557 (11th Cir.), *cert. denied*, __U.S.__, 107 S.Ct. 274, 93 L.Ed.2d 250 (1986).

In sum, we conclude that as a result of the district court's erroneous analysis of the fraud-on-the-market claims and its mischaracterization of the misrepresentations claims, the court incorrectly determined that individual issues predominated over common issues. Contrary to the court's conclusions, these claims involve common issues that clearly overwhelm the individual issues that may be present. Consequently, "[s]eparate actions by each of the class members would be repetitive, wasteful, and an extraordinary burden on the courts." *Kennedy v. Tallant*, 710

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[5] The presence of arbitration agreements is relevant for another factor in determining the suitability of class treatment on the 10b-5 claims. After the district court's order was issued, the Supreme Court in *Shearson/American Express v. McMahon*, __U.S.__, 107 S.Ct. 2332, 96 L.Ed.2d 185 (1987), upheld the enforceability of agreements requiring the arbitration of 10b-5 claims. Those purchasers whose 10b-5 claims are subject to arbitration thus could not be considered members of the class. In ruling on the motion for class certification, the district court did not determine whether the potential class members not subject to arbitration would be sufficient to satisfy the numerosity requirement of Rule 23(a)(2). The court should make this determination on remand.

F.2d at 718. The district court thus abused its discretion in ruling that the requirements of Rule 23(b)(3) were not satisfied in this case. *See, e.g., Cox v. American Cast Iron Pipe Co.*, 784 F.2d at 1557-58.

### B. *State Law Claims*

In concluding that the state law claims failed to satisfy the requirements of Rule 23(b)(3), the district court reasoned that the differing standards of liability required by the laws of the various states would render class action treatment unmanageable. We agree with the district court that the state law claims would require application of the standards of liability of the state in which each purchase was transacted.* The district court thus did not abuse its discretion in denying class certification on these claims. *See, e.g., Simon v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 482 F.2d at 883.

### C. *Section 11 and 12(2) Claims*

In explaining its denial of class certification of the section 11 and 12(2) claims, the district court stated that it "did not

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* Under the Georgia law applicable to these diversity claims, *see Klaxon Co. v. Stentor Electric Mfg. Co.*, 313 U.S. 487, 61 S.Ct. 1020, 85 L.Ed. 1477 (1941), the standard of liability would be determined, as an initial matter, by the law of the state in which the purchaser acquired the security, not of the state from which the shares were sold. *See Risdon Enterprises, Inc. v. Coleman Enterprises, Inc.*, 172 Ga. App. 902, 324 S.E.2d 738, 740 (1984) (explaining Georgia's *lex loci delecti* choice of law rule in tort cases); *see also Zandman v. Joseph*, 102 F.R.D. 924, 930 (N.D.Ind.1984) (Indiana's *lex loci delecti* rule "would require use of the law of the state where each class member suffered his or her pecuniary loss"). If a particular state does not have a controlling statute, however, the Georgia choice of law rule requires application of the common law as construed by the courts of Georgia. *See Frank Briscoe, Inc. v. Georgia Sprinkler Co., Inc.*, 713 F.2d 1500, 1503 (11th Cir.1983); *Risdon Enterprises*, 324 S.E.2d at 741 (1984). Thus, although the law of Georgia might eventually be applied on some claims involving purchases made in other states, that could be determined only after the district court had fully surveyed the law of the states of purchase. Moreover, even if Georgia law would require application of its own common law rules to some claims involving purchases in other states, the law of Georgia could be applied consistent with due process only if the particular transaction had some significant relation to Georgia. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 105 S.Ct. 2965, 2980, 86 L.Ed.2d 628 (1985).

address" these claims individually because to separate these claims from the Rule 10b-5 and state law claims would be "unduly burdensome" on the court. The court consequently denied class certification of the Rule 11 and 12(2) claims based upon its conclusion that the 10b-5 and the state law claims did not meet the requirements of Rule 23(b)(3). In view of our determination that the court erroneously ruled that 10b-5 claims did not meet the requirements of Rule 23(b)(3), the court must of course reconsider its decision regarding the Section 11 and 12(2) claims.

Independent of our decision on the 10b-5 claims, however, we conclude that the court erred in failing to consider separately the appropriateness of the class action treatment of the section 11 and 12(2) claims. Although there is some overlap between section 10(b) and sections 11 and 12(2), the provisions "involve distinct causes of action and were intended to address different types of wrongdoing." *Herman & McLean v. Huddleston*, 459 U.S. 375, 103 S.Ct. 683, 687, 688, 74 L.Ed.2d 548 (1983). The failure of the district court to give separate consideration to class action certification of these distinct claims thus could serve neither the securities laws' purpose of protecting investors, *see, e.g., id.*, 103 S.Ct. at 687, nor Rule 23's purpose of protecting the courts from needlessly repetitious litigation, *see, e.g., Kennedy v. Tallant*, 710 F.2d at 718. By failing to consider these claims separately, the court abused its discretion.

## III. ADEQUATE CLASS REPRESENTATION

Having concluded that the district court's ruling on the requirements of Rule 23(b)(3) constituted an abuse of the court's discretion, we must address the court's alternative holding that the named plaintiffs in each of these cases did not satisfy the adequate representation requirement of Rule 23(a)(4) because they failed to demonstrate sufficient "vigor" to prosecute a class suit.

Among the prerequisites to the maintenance of a class action is the requirement of Rule 23(a)(4) that the class representatives

"will fairly and adequately protect the interests of the class." The purpose of this requirement, as of many other of Rule 23's procedural mandates, is to protect the legal rights of absent class members. Because all members of the class are bound by the res judicata effect of the judgment, a principal factor in determining the appropriateness of class certification is "the forthrightness and vigor with which the representative party can be expected to assert and defend the interests of the members of the class." *Mersay v. First Republic Corp.*, 43 F.R.D. 465, 470 (S.D.N.Y.1968); *see also Shatzman v. Talley*, 91 F.R.D. 270, 273 (N.D.Ga.1981) (insufficiency of funds to prosecute suit indicates the "vigor with which the case will be pursued"); *Dolgow v. Anderson*, 43 F.R.D. 472, 494 (E.D.N.Y.1968) (court "must be assured that 'the representatives [will] put up a real fight' " (*quoting* J. Chafee, Some Problems in Equity 231 (1950)), *rev'd on other grounds*, 438 F.2d 825 (2d Cir.1971); *cf. Falcon*, 457 U.S. at 161, 102 S.Ct. at 2372.

The inquiry into whether named plaintiffs will represent the potential class with sufficient vigor to satisfy the adequacy requirement of Rule 23(a)(4) most often has been described to "involve[ ] questions of whether plaintiffs' counsel are qualified, experienced, and generally able to conduct the proposed litigation and of whether plaintiffs have interests antagonistic to those of the rest of the class." *Griffin v. Carlin*, 755 F.2d 1516, 1532 (11th Cir.1985). Even where these two requirements are satisfied, however, named plaintiffs might not qualify as adequate class representatives because they do not possess the personal characteristics and integrity necessary to fulfill the fiduciary role of class representative. *See, e.g., Kline v. Wolf*, 702 F.2d 400, 402-03 (2d Cir.1983); *Armour v. City of Anniston*, 89 F.R.D. 331, 332 (D.C.Ala.1980), *aff'd*, 654 F.2d 382 (5th Cir. Unit B Aug. 1981); 7A C. Wright, A. Miller and M. Kane, Federal Practice and Procedure, Civil 2d § 1766 at pp. 308-10.

For similar reasons, some courts have found, as did the district court here, that Rule 23(a)(4) was not satisfied where the named plaintiffs demonstrated insufficient participation in and awareness of the litigation. *See, e.g., Darvin v. International Harvester Co.*, 610 F. Supp. 255, 257 (S.D.N.Y.1985);

*Massengill v. Board of Educ.*, 88 F.R.D. 181 (N.D.Ill.1980). In following the lead of these cases, however, the district court appears to have applied a standard that does not vindicate the policies and purposes of Rule 23. Contrary to the district court's approach to the issue, adequate class representation generally does not require that the named plaintiffs demonstrate to any particular degree that individually they will pursue with vigor the legal claims of the class. Although the interests of the plaintiff class certainly would be better served if the named plaintiffs fully participate in the litigation, *see, e.g., In re Goldchip Funding Co.*, 61 F.R.D. 592, 594-95 (M.D.Pa.1974), the economics of the class action suit often are such that counsel have a greater financial incentive for obtaining a successful resolution of a class suit than do the individual class members. *See Deposit Guaranty Nat. Bank v. Roper*, 445 U.S. 326, 338-39, 100 S.Ct. 1166, 1174, 63 L.Ed.2d 427 (1980) (plurality opinion). It is not surprising, then, that the subjective desire to vigorously prosecute a class action, which the district court here found missing in the named plaintiffs, quite often is supplied more by counsel than by the class members themselves. Obviously this creates a potential for abuse. *See id.* at 339, 100 S.Ct. at 1174. Yet the financial incentives offered by the class suit serve both the public interests in the private enforcement of various regulatory schemes, particularly those governing the securities markets, and the private interests of the class members in obtaining redress of legal grievances that might not feasibly be remedied "within the framework of a multiplicity of small individual suits for damages." *Id.*

As the district court aptly noted, a potential class is entitled to "more than blind reliance upon even competent counsel by uninterested and inexperienced representatives." *In re Goldchip Funding Co.*, 61 F.R.D. at 594. For where the named plaintiffs "have abdicated their role in the case beyond that of furnishing their names as plaintiffs," the attorneys, in essence, are the class representative. *Helfand v. Cenco*, 80 F.R.D. 1, 7-8 (N.D.Ill.1977). Several district courts thus have properly denied class certification where the class representatives had so little knowledge of and involvement in the class action that they would be unable

or unwilling to protect the interests of the class against the possibly competing interests of the attorneys. *See, e.g. Efros v. Nationwide Corp.*, 98 F.R.D. 703, 707 (S.D.Ohio 1983); *Helfand v. Cenco, supra; see also* 7A Wright, Miller & Kane at § 1766 pp. 310-11 (the "inquiry into the knowledge of the representative is to ensure that the party is not simply lending his name to a suit controlled entirely by the class attorney.")

In concluding that the named plaintiffs in these cases do not satisfy the adequate representation requirement of Rule 23(a)(4), the district court noted that neither this court nor the Supreme Court has set forth standards for determining the adequacy of class representatives.[7] Because the issue of adequate class representation arises in a wide variety of contexts, it would be inappropriate for us to establish a standard for general application. We conclude, however, that in securities cases such as these, where the class is represented by competent and zealous counsel, class certification should not be denied simply because of a perceived lack of subjective interest on the part of the named plaintiffs unless their participation is so minimal that they virtually have abdicated to their attorneys the conduct of the case. To require less would permit attorneys essentially to serve as class

---

[7] In support of its conclusion that the named plaintiffs in these cases are inadequate class representatives, the court cited *Rothenberg v. Security Management Co., Inc.*, 667 F.2d 958 (11th Cir. 1982). *Rothenberg* upheld the dismissal of a Rule 23.1 derivative shareholders' action where the named plaintiff had been found not to be an adequate representative of the other shareholders. In making this determination, the district court and the panel on appeal relied on factors similar to those relied upon by the district court here. *Rothenberg*, however, is not entirely apposite to the determination of adequacy of a class representative under Rule 23(a)(4). A derivative suit poses inherent conflicts between those minority shareholders who are bringing the suit and the majority shareholders whose administration is being challenged either directly or indirectly. *See 7C C. Wright, A. Miller & M. Kane, Federal Practice and Procedure* § 1833 at pp. 137-39. In contrast, a class suit by definition serves to benefit the members of the class. Consequently, a different degree of participation might well be required of a named plaintiff in a Rule 23.1 derivative than of a named plaintiff in a Rule 23 class action. The case before us does not involve a Rule 23.1 certification, and we express no opinion as to what the standard for such cases should be.

representatives; to require more could well prevent the vindication of the legal rights of the absent class members under the guise of protecting those rights.

Although we conclude that the district court applied an erroneous standard in determining that the named plaintiffs would not be adequate class representatives, it would be inappropriate for us to make an independent application of the correct standard in this case. In contrast to the more strictly legal questions presented by the district court's characterization of the plaintiffs' claims in its rulings on the Rule 23(b)(3), the adequacy of class representation is primarily a factual issue that is best left for determination by the district court. Consequently, we remand the Rule 23(a)(4) issue for the district court to apply the standard we have set forth above.

## IV. CONCLUSION

For the foregoing reasons, the order of the district court is REVERSED IN PART, AFFIRMED IN PART, and REMANDED with instructions.

UNITED STATES COURT OF APPEALS
Eleventh Circuit
56 Forsyth Street, N.W.
Atlanta, Georgia 30303
October 21, 1987

Miguel J. Cortez
Clerk

In Replying Give Number
Of Case and Names Of Parties

MEMORANDUM TO COUNSEL OR PARTIES LISTED BELOW:

NOS. 86-8624, 86-8625 & 86-8626
SUZANNE KIRKPATRICK, et al. v. J.C. BRADFORD & CO.
(Nos. C85-1891A, C85-172A & C85-1586A)

---

The enclosed order has been entered on petition(s) for rehearing.

See Rule 41, Federal Rules of Appellate Procedure, and Eleventh Circuit Rule 41-1 for information regarding issuance and stay of mandate.

Sincerely,

MIGUEL J. CORTEZ, Clerk

By: /s/ Pam Holloway
Deputy Clerk

Encl.

Brenda M. Nelson
Kenneth A. Jacobsen
Richard D. Greenfield
Richard M. Kirby
Robert E. Zimet
Glenn Delk
Ames Davis
Robert E. Boston
Lloyd S. Clareman
Harvey D. Myerson
Bradley C. Twedt
Timothy J. Carey
Peter J. Anderson
Mack Young

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

No. 86-8624

SUZANNE KIRKPATRICK;
DOROTHY D. CASLER and
CHARLES H. LINDSEY, on
behalf of themselves and
all others similarly situated,

Plaintiffs-Appellants,

versus

J.C. BRADFORD & CO.,

Defendant-Appellee.

No. 86-8625

GLENN T. SANDERS on behalf
of himself and all others
similarly situated, and
LESLIE D. SANDERS,

Plaintiffs-Appellants,

versus

ROBINSON HUMPHREY/AMERICAN
EXPRESS, INC., and SHEARSON/AMERICAN
EXPRESS, INC.,

Defendants-Appellees.

NO. 86-8626

TOMMY E. PARKER, as custodian
for KIMBERLY M. PARKER and JAMES L.
SMITH, on behalf of themselves and
all others similarly situated,

Plaintiffs-Appellants,

versus

PAINE WEBBER GROUP, INC.,

Defendant-Appellee.

Appeals from the United States District Court for the
Northern District of Georgia

ON PETITION(S) FOR REHEARING AND SUGGESTION(S)
OF REHEARING IN BANC

(Opinion September 15, 11 Cir., 1987, ____ F.2d ____).
(October 21, 1987)

Before VANCE and KRAVITCH, Circuit Judges, and BROWN*,
Senior Circuit Judge.
PER CURIAM:

(×) The Petition(s) for Rehearing are DENIED and no member of this panel nor other Judge in regular active service on the Court having requested that the Court be polled on rehearing in banc (Rule 35, Federal Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing In Banc are DENIED.

( ) The Petition(s) for Rehearing are DENIED and the Court having been polled at the request of one of the members of the Court and a majority of the Circuit Judges who are in regular active service not having voted in favor of it (Rule 35, Federal

Rules of Appellate Procedure; Eleventh Circuit Rule 35-5), the Suggestion(s) of Rehearing In Banc are also DENIED.

( ) A member of the Court in active service having requested a poll on the reconsideration of this cause in banc, and a majority of the judges in active service not having voted in favor of it, Rehearing In Banc is DENIED.

ENTERED FOR THE COURT:

/s/ Phyllis Kravitch
United States Circuit Judge

* Honorable John R. Brown, Senior U.S. Circuit Judge for the Fifth Circuit, sitting by designation.

UNITED STATES COURT OF APPEALS
Eleventh Circuit
56 Forsyth Street, N.W.
Atlanta, Georgia 30303

Miguel J. Cortez
Clerk

In Replying Give Number
Of Case And Names Of Parties

November 17, 1987

TO: ALL COUNSEL LISTED BELOW:

No. 86-8624, 86-8625 & 86-8626
KIRKPATRICK, et al. v. BRADFORD, et al.

---

MANDATE STAYED TO AND INCLUDING November 23, 1987.

The court has this day granted a stay of the mandate to the date shown above. If during the period of the stay there is filed in this court a notice from the Clerk of the Supreme Court that the party who has obtained the stay has filed a petition for writ of certiorari in the Supreme Court, the stay shall continue until final disposition by the Supreme Court. Upon the filing of a copy of an order of the Supreme Court denying the petition for writ of certiorari, the mandate shall issue forthwith. See Fed.R.App.P. 41.

The Clerk of the Supreme Court has requested the clerks of the federal courts of appeal to retain the record on appeal until the Supreme Court requests that it be transmitted. Parties will be advised when this occurs. Accordingly, please refrain from routinely requesting transmittal of the record. See Supreme Court Rule 19.1.

A copy of this court's opinion (or Rule 36-1 decision), the judgment, and any order on rehearing should be attached as an appendix to any petition for writ of certiorari (or jurisdictional statement) filed. See Supreme Court Rules 21(k), 15(j).

( ) This court has also directed recall of the mandate. By copy of this letter the clerk of the district court is requested to return the opinion and judgment previously issued as mandate.

Sincerely,

MIGUEL J. CORTEZ, Clerk

By: /s/ Pam Holloway
Deputy Clerk

Glenn Delk
Kenneth A. Jacobsen
Richard D. Greenfield
Ames Davis
Robert E. Boston
Lloyd S. Clareman
Harvey D. Myerson
Bradley C. Twedt
Timothy J. Carey
Peter J. Anderson
Mack Young
Brenda M. Nelson
Richard M. Kirby
Robert E. Zimet

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

---

No. 86-8624

---

SUZANNE KIRKPATRICK;
DOROTHY D. CASLER and
CHARLES H. LINDSEY, on
behalf of themselves and
all others similarly situated,

Plaintiffs-Appellants,

versus

J.C. BRADFORD & CO.,

Defendant-Appellee.

---

No. 86-8625

---

GLENN T. SANDERS on behalf
of himself and all others
similarly situated, and
LESLIE D. SANDERS,

Plaintiffs-Appellants,

versus

ROBINSON HUMPHREY/AMERICAN
EXPRESS, INC., and SHEARSON/AMERICAN
EXPRESS, INC.,

Defendants-Appellees.

No. 86-8626

TOMMY E. PARKER, as custodian for KIMBERLY M. PARKER and JAMES L. SMITH, on behalf of themselves and all others similarly situated,

Plaintiffs-Appellants,

versus

PAINE WEBBER GROUP, INC.,

Defendant-Appellee,

FILED
U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
NOV 17
MIGUEL J. CORTEZ, CLERK

Appeal from the United States District Court for the Northern District of Georgia

ORDER:

( ) The motion of Appellees, J.C. BRADFORD & CO., et al. for (xx) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is DENIED.

(x) The motion of Appellees, J.C. BRADFORD & CO., et al. for (xx) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including Nov. 23rd 1987, the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within the period above mentioned there shall be filed wtih the Clerk of this Court the

certificate of the Clerk of the Supreme Court that the certiorari petition has been filed. The Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon expiration of the stay granted herein, unless the above mentioned certificate shall be filed with the Clerk of this Court within that time.

( ) The motion of _____ for a further stay of the issuance of the mandate is GRANTED to and including _____, under the same conditions as set forth in the preceding paragraph.

( ) IT IS ORDERED that the motion of _____ for a further stay of the issuance of the mandate is DENIED.

/s/ Phyllis Kravitch
UNITED STATES CIRCUIT JUDGE

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE ELEVENTH CIRCUIT**

---

**NO. 86-8624**

---

SUZANNE KIRKPATRICK;
DOROTHY D. CASLER and
CHARLES H. LINDSEY, on
behalf of themselves and
all others similarly situated,
*Plaintiffs-Appellants,*

versus

J.C. BRADFORD & CO.,
*Defendant-Appellee.*

---

**No. 86-8625**

---

GLENN T. SANDERS on behalf
of himself and all others
similarly situated, and
LESLIE D. SANDERS,
*Plaintiffs-Appellants,*

versus

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., and
SHEARSON/AMERICAN EXPRESS, INC.,
*Defendants-Appellees.*

*Filed*
*Nov 17 1987*

---

**No. 86-8626**

---

TOMMY E. PARKER, as custodian
for KIMBERLY M. PARKER and JAMES L. SMITH,
on behalf of themselves and
all others similarly situated,
*Plaintiffs-Appellants,*

versus

PAINE WEBBER GROUP, INC.,
*Defendant-Appellee.*

---

**Appeal from the United States District Court for the Northern District of Georgia**

---

ORDER:

( ) The motion of Appellees, J.C. BRADFORD & Co., *et al.* for (XX) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is DENIED.

(X) The motion of Appellees, J.C. BRADFORD & Co., *et al.* for (XX) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including Nov. 23rd 1987, the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within the period above mentioned there shall be filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court that the certiorari petition has been filed. The Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon expiration of the stay granted herein,

unless the above mentioned certificate shall be filed with the Clerk of this Court within that time.

( ) The motion of _____ for a further stay of the issuance of the mandate is GRANTED to and including _____, under the same conditions as set forth in the preceding paragraph.

( ) IT IS ORDERED that the motion of _____ for a further stay of the issuance of the mandate is DENIED.

PHYLLIS KRAVITCH
UNITED STATES CIRCUIT JUDGE

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE ELEVENTH CIRCUIT**

---

**No. 86-8624**

---

SUZANNE KIRKPATRICK;
DOROTHY D. CASLER and
CHARLES H. LINDSEY, on
behalf of themselves and
all others similarly situated,
*Plaintiffs-Appellants,*

versus

J.C. BRADFORD & CO.,
*Defendant-Appellee.*

---

**No. 86-8625**

---

GLENN T. SANDERS on behalf
of himself and all others
similarly situated, and
LESLIE D. SANDERS,
*Plaintiffs-Appellants,*

versus

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., and
SHEARSON/AMERICAN EXPRESS, INC.,
*Defendants-Appellees.*

*Filed*
*Nov 20 1987*

**IN THE UNITED STATES COURT OF APPEALS**
**FOR THE ELEVENTH CIRCUIT**

---

**No. 86-8626**

---

TOMMY E. PARKER, as custodian
for KIMBERLY M. PARKER and JAMES L. SMITH,
on behalf of themselves and
all others similarly situated,
*Plaintiffs-Appellants,*

versus

PAINE WEBBER GROUP, INC.,
*Defendant-Appellee.*

---

**Appeal from the United States District Court for the Northern District of Georgia**

---

ORDER:

( ) The motion of _____ for ( ) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is DENIED.

( ) The motion of _____ for ( ) stay ( ) recall and stay of the issuance of the mandate pending petition for writ of certiorari is GRANTED to and including _____, the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within the period above mentioned there shall be filed with the Clerk of this Court the certificate of the Clerk of the Supreme Court that the certiorari petition has been filed. The Clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon

expiration of the stay granted herein, unless the above mentioned certificate shall be filed with the Clerk of this Court within that time.

(X) The motion of Appellee, J.C. BRADFORD & Co., for a further stay of the issuance of the mandate is GRANTED to and including December 7, 1987, under the same conditions as set forth in the preceding paragraph.

( ) IT IS ORDERED that the motion of Appellee, J.C. BRADFORD & Co. for a further stay of the issuance of the mandate is DENIED.

PHYLLIS KRAVITCH
UNITED STATES CIRCUIT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

GLENN T. SANDERS, on behalf of himself and all others similarly situated,

*Plaintiffs,*

vs.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., *et al.*,

*Defendants.*

CIVIL ACTION No. C 85-172 A

---

TOMMY E. PARKER, as custodian for KIMBERLY M. PARKER, and JAMES L. SMITH, on behalf of themselves and others similarly situated,

*Plaintiffs,*

vs.

PAINE WEBBER GROUP, INC.,

*Defendant.*

CIVIL ACTION No. C 85-1586 A

---

SUZANNE KIRKPATRICK, DOROTHY D. CASLER, and CHARLES H. LINDSEY,

*Plaintiffs,*

vs.

J.C. BRADFORD & CO.,

*Defendants.*

CIVIL ACTION No. C 85-1891 A

---

March 27, 1986

## ORDER

VINING, District Judge.

In these federal securities actions, the plaintiffs have filed motions for class certification, pursuant to Rule 23 of the Federal Rules of Civil Procedure. The court already has considered and ruled on the defendants' motions to dismiss and numerous discovery and procedural motions. These cases are now ripe for a determination of whether they may proceed as class actions.[1] An understanding of the history of the Petro-Lewis cases is necessary before the court considers the motions for class certification.

### I. HISTORY OF THE PETRO-LEWIS LITIGATION

From 1970 to 1983, Petro-Lewis was the nation's largest seller of oil and gas income funds. These programs raised money from investors, who became limited partners, and used the proceeds to purchase oil and gas producing properties. Cash distributions to the limited partners, which were paid quarterly, began almost immediately after each partnership was formed and were to continue for 10 to 15 years or more until the wells were depleted. Petro-Lewis, an independent oil and gas producer and manager of petroleum investments for public and private partners, acquired oil and gas properties for public limited partnerships, shared ownership of those properties, and managed the limited partnerships as a general partner. Over a 14-year period, Petro-Lewis sold, through securities brokerage firms, in excess of $3 billion worth of partnerships to approximately 180,000 people.

As oil and gas prices began to decline in 1981 and 1982, Petro-Lewis was forced to borrow funds to pay partnership distributions, service the debt it was incurring, and promote the sale of additional programs. In February 1984 Petro-Lewis revealed that it would sustain a substantial loss, that it was cutting

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[1] On October 28, 1985, this court held that a companion case, *Chandler v. Drexel Burnham Lambert, Inc.*, C85-1585A (N.D. Ga. 1985), should be sent to arbitration. The plaintiff has appealed that decision to the Eleventh Circuit Court of Appeals.

distributions to limited partners by as much as 50 percent, that the company would have to sell between one quarter and one third of its total reserves to reduce bank debt, and that Petro-Lewis was immediately terminating all sales of partnership programs. Numerous lawsuits against Petro-Lewis followed.

In In re Petro-Lewis Securities Litigation [1984-85 Transfer Binder], Fed. Sec. L. Rep. ¶ 91,899 (D. Colo. 1984), the court set forth the history of the Petro-Lewis litigation that lead to these class actions.[3] In that case, the court consolidated eleven class actions filed between February 9, 1984, and May 9, 1984. The defendants were the Petro-Lewis Corporation, the Petro-Lewis Funds, Petro-Lewis Securities Corporation, and the seven directors of Petro-Lewis Corporation. The amended consolidated class action complaint set forth claims under the Securities Exchange Act of 1934, as amended, 15 U.S.C. §§ 78a, *et seq.*, and the Securities Act of 1933, as amended, 15 U.S.C. §§ 77a, *et seq.* The plaintiffs in the original Colorado action sought to represent two classes: (1) a "securities class," consisting of the purchasers of securities, including common stock, warrants, and preferred stock, and (2) a "partnership class," consisting of persons who purchased, reinvested in, or otherwise acquired limited partnership interests in over 100 partnerships formed by Petro-Lewis to purchase oil and natural gas producing properties between August 1975, and February 1984, and in the Petro-Lewis deferred income program formed in 1981. The Petro-Lewis complaint alleged that during the relevant times the defendants made, or caused to be made, statements in Petro-Lewis prospectuses, periodic shareholder and investor reports, filings with the Securities and Exchange Commission, press releases, investor letters, and other documents, that were materially false and misleading and that the defendants omitted to disclose certain material facts and adverse information about Petro-Lewis and the partnerships that it managed. Some plaintiffs sought relief in the form of rescission of their purchases of limited partnership interests. All plaintiffs sought damages, interest, costs, and disbursements.

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[3] The facts set forth in part I are taken from Judge Carrigan's opinion in the Colorado litigation.

On July 3, 1984, co-lead counsel for the plaintiffs and counsel for the defendants in the Colorado litigation executed an agreement in principle to settle all eleven class actions. The settlement agreement consisted of two primary components: (1) formation of a royalty trust, and (2) creation by the defendants of a settlement fund consisting of cash and non-cash considerations valued at $23.5 million. Notices were sent to approximately 180,000 holders of limited partnership interests in 45 limited partnerships, plus approximately 7,000 members of the stockholder class. In addition, 40,000 notices were sent to brokers for forwarding to persons on whose behalf interests were held. According to a public announcement made December 26, 1984, all 45 affected limited partnerships voted, by very substantial margins, in favor of the settlement. The settlement required Petro-Lewis, on behalf of all defendants, to contribute consideration of $23.5 million to a settlement fund, which included $10 million in cash plus approximately 720,000 trust units valued at $13.5 million.

The class members who participated in the settlement were to sign a release form which provided that all the defendants, and any subsidiary or affiliate of Petro-Lewis, would be released with respect to all claims, demands, and causes of action. The release form, however, was not intended to release any broker-dealer in its capacity as an agent for Petro-Lewis or any of its affiliates in connection with the issuance, purchase, or sale of any of the securities of, or interest in, Petro-Lewis, or any of the limited partnerships of which Petro-Lewis or any subsidiary or affiliate of Petro-Lewis was a general partner. Counsel for all parties agreed that the purpose and intent of the release was solely to protect the defendants in the Colorado action and that it was intended that all the plaintiff class members retain any rights that they might have to proceed against and collect from broker-dealers or other nondefendants who might be liable to them.

The court conditionally certified the partnership class and the securities class for purposes of settlement only. The court indicated that there were serious questions of law and fact which

placed the outcome of the class actions, if tried rather than settled, in substantial doubt. One such question was:

> In view of the substantial number of distinct partnerships and the variations in facts relevant to, and potential conflicts among, the claims of those partnerships, there is doubt whether this action could be certified under Fed. R. Civ. P. 23 (except conditionally, for settlement purposes) and, if certified, whether the partnership class would have to be splintered into numerous subclasses.

¶ 91,889 at 90,470.

After carefully examining the proof of claim and release forms and the notices to be sent out, the court approved the proposed settlement as fair, reasonable, and adequate for all members of the plaintiff classes.

## II. THE INSTANT LITIGATION

The plaintiffs seek to represent individuals who purchased, reinvested in, or acquired from the defendants limited partnership interests in Petro-Lewis income programs from January 1, 1981, to February 6, 1984. The amended complaints in these three proposed class actions are divided into three parts. The plaintiffs spend 30 pages setting forth the alleged wrongdoings by Petro-Lewis. For example, the amended complaint alleges that statements made in the Petro-Lewis prospectuses from 1981 to 1984 were false and misleading because they did not disclose the risks inherent in purchasing Petro-Lewis partnership interests. Amended Complaint ¶ 22.[3] Petro-Lewis also allegedly failed to disclose excessive leveraging of all partnerships, made unsecured loans to partnerships to inflate distributions to limited partners and to attract new sales, made false and misleading financial statements, annual and periodic reports, press releases

---

[3] References to paragraphs in this part of the order refer to the *Sanders v. Robinson-Humphrey* amended complaint, although the other two amended complaints are substantially similar.

and newsletters, and failed to disclose that substantial tax benefits expected to be received by limited partnership investors were likely to be disallowed. *Id.* at ¶¶ 22-23. Petro-Lewis also allegedly failed to inform the investing public of the risks involved in the Petro-Lewis method of operation, including competition in the industry by less risky investment programs and the severe difficulty of obtaining debt servicing. *Id.* at ¶ 23.

A *Wall Street Journal* article on April 5, 1983, reported that Petro-Lewis was "facing an apparent cash squeeze that might lead to nasty surprises for holders." The article stated that Petro-Lewis had " 'leveraged' or invested in a larger value of oil properties than the original cash put up." *Id.* at ¶ 24. Petro-Lewis issued a press release denying substantially all of the statements made in the *Wall Street Journal* article and allegedly maintained artificially high distribution to the partnerships to attract new partnership sales. *Id.* Finally, on February 6, 1984, Petro-Lewis allegedly revealed the following: that it had severe losses, that it was cutting its distribution by 50 percent, that it was reducing the price at which Petro-Lewis agreed to repurchase partnership interests, that it was drastically reducing its work force, and that it was immediately terminating all sales of partnership programs. *Id.* at ¶¶ 35-36. At the time Petro-Lewis made these revelations, reserves bought by many partnerships were worth only 1/3 to 1/2 what the partnerships paid for them. *Id.* at ¶ 36.

In the second part of the complaints, the plaintiffs set forth the defendants' alleged roles in the sales scheme. According to the complaints, Petro-Lewis partnership interests were marketed by selected members of the National Association of Securities Dealers, including the defendants in this action, pursuant to selling agreements with Petro-Lewis securities corporation, a wholly owned subsidiary of Petro-Lewis. Each brokerage house allegedly received sales commissions of up to seven percent on each partnership interest sold, plus a special sales incentive payment of 1-1/2 percent when the brokerage house's sales in a program exceeded $400,000. *Id.* at ¶ 38. Sales of the Petro-Lewis partnership interests allegedly were a significant source of

revenue and profit to the defendants. *Id.* at ¶ 40. The plaintiffs contend that the defendants trained and instructed their account representatives in standard techniques to promote, solicit, sell, and induce customers to purchase Petro-Lewis partnership interests. During the class period, the defendants allegedly provided to the plaintiffs and the proposed classes the prospectuses, financial statements, annual and periodic reports, press releases, and other statements described in part I of the complaints. In addition, the plaintiffs assert that the defendants made numerous uniform statements of fact and verbal assurances to the plaintiffs and the members of the proposed classes to the effect that Petro-Lewis' public statements were worthy of the plaintiffs' trust and belief, that Petro-Lewis was operating soundly, and that Petro-Lewis partnerships were good investments from which high long-term yields could be expected at minimal risk. *Id.* at ¶ 41.

The defendants allegedly knew or recklessly disregarded information available to them which disclosed or would have disclosed the financial problems of Petro-Lewis and its partnerships as described in part I of the complaints. *Id.* at ¶ 43. Even though the defendants allegedly knew or should have known these facts, they continued to market and sell Petro-Lewis partnership interests to the plaintiffs and members of the proposed classes during the class period without disclosing any of the facts asserted in part I of the complaints. The plaintiffs assert that the defendants characterized the Petro-Lewis partnership interests as relatively low risk investments when they were clearly known to be high risk investments and that the defendants uniformly dissuaded and discouraged customers, including the plaintiffs and the members of the proposed classes, from selling or liquidating their interests in the Petro-Lewis partnership programs. *Id.* at ¶ 44. The plaintiffs allege that the defendants knew or recklessly disregarded facts contributing to Petro-Lewis' financial problems, the vulnerability of Petro-Lewis' partnership programs caused by the pattern of excessive leveraging instituted by Petro-Lewis management, and the high degree of risk involved in any investment in the Petro-Lewis partnership

programs. *Id.* at ¶ 45. The plaintiffs and their proposed classes allege that as a result of the foregoing, they were damaged. *Id.* at ¶ 46.

Part III of the amended complaints sets forth the seven counts that form the basis of this lawsuit. Count I, brought pursuant to section 11 of the Securities Act of 1933, 15 U.S.C. § 77k, alleges that the defendants issued, caused to be issued, participated in the issuance of, or aided and abetted the issuance of materially false and misleading statements to the investing public that appeared in publicly disseminated materials relating to Petro-Lewis and its partnership programs during the class period, including the registration statements and the prospectuses that misrepresented and failed to disclose the facts set forth in part I of the complaints. *Id.* at ¶ 53. Count II, brought pursuant to section 12(2) of the Securities Act, 15 U.S.C. § 77*l*(2), alleges that the defendants made untrue statements of material fact or omitted to state material facts in the prospectuses, newsletters, releases, and instruction booklets. The defendants also allegedly used the means and instruments of transportation or communication in interstate commerce or the mails to perform these violations of section 12(2). *Id.* at ¶ 58.* Count III, brought pursuant to section 15 of the Securities Act, 15 U.S.C. § 77o, the "controlling person" liability provision for sections 11 and 12, alleges that the named defendants directly or indirectly controlled the activities of the brokerage houses as underwriters of the Petro-Lewis partnership interests and programs and were responsible for the content of the Petro-Lewis registration statement and prospectuses during the class period, or directly or

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* In all three class action cases, the defendants filed motions to dismiss, contending that section 13 of the Securities Act, 15 U.S.C. § 77m, the statute of limitations for sections 11 and 12(2), barred these counts. In *Sanders v. Robinson-Humphrey*, the court dismissed the plaintiffs' claims for their 1981 purchases. *See* Order filed Sept. 11, 1985. In *Kirkpatrick v. J. C. Bradford*, the court dismissed Counts I and II since the claims were barred by the statute of limitations. The court allowed the plaintiffs' attorneys to communicate with potential class members in an attempt to find plaintiffs not barred by the statute of limitations. *See* Order filed Sept. 11, 1985. In *Parker v. Paine Webber*,

*(Footnote continued)*

indirectly induced the acts alleged in Counts I and II. *Id.* at ¶ 64.[5] Count IV alleges a cause of action under sections 10 and 20 of the Securities Exchange Act of 1934, 15 U.S.C. § 78j and § 78t, and Rule 10b-5, 17 C.F.R. § 240.10b-5.[6]

In addition to the federal securities claims, the plaintiffs allege common law fraud and deceit (Count V), negligence and negligent misrepresentation (Count VI), and fraudulent concealment and breach of fiduciary duty (Count VII). The amended complaint in *Parker v. Paine Webber* also alleges a cause of action under the Racketeer Influenced and Corrupt Organizations Act (RICO), 18 U.S.C. § 1962(c).

Each of the complaints demand judgment against the defendants for compensatory damages, the costs and disbursements of the action, including reasonable attorneys' fees, and punitive and exemplary damages in the amount of $10 million. In addition, the plaintiffs requested that this court determine that these complaints may proceed as class actions under Rule 23 of the Federal Rules of Civil Procedure.

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the court dismissed Counts I and II. *See* Order filed Sept. 11, 1985. The plaintiffs amended their complaint, and the court denied the defendant's motion to dismiss Counts I and II of the amended complaint. *See* Order filed Feb. 14, 1986.

[5] A claim against a controlling person is governed by the same limitations period that applies to the Securities Act claim against the controlled person. This court held that section 13, therefore, also applied to the plaintiffs' section 15 claim. *See Herm v. Stafford*, 663 F.2d 669, 679 (6th Cir. 1981). As a result, Count III in *Kirkpatrick* was dismissed. *See* Order filed Sept. 11, 1985. The amended complaint in *Parker v. Paine Webber* did not allege a cause of action under section 15.

[6] The cause of action under section 20 was dismissed in *Kirkpatrick v. J. C. Bradford* and not alleged in the amended complaint in Parker v. Paine Webber.

The defendants, in their motions to dismiss this count, alleged that the plaintiffs failed to plead fraud with sufficient particularity to satisfy Rule 9(b) of the Federal Rules of Civil Procedure. The court declined to dismiss on this ground. *See* Orders filed Sept. 11, 1985.

The parties have engaged in extensive preliminary discovery on the class certification question. The court held an evidentiary hearing on Febraury 27, 1986, and the parties submitted briefs before and after the hearing.

## III. FRAMEWORK OF ANALYSIS

A party that seeks to invoke Rule 23 has the burden of proving that all of the prerequisites to utilizing the class action procedure have been satisfied. *Zeidman v. J. Ray McDermott & Co.*, 651 F.2d 1030, 1038 (5th Cir. 1981).[7] The burden of satisfying the requirements of Rule 23 falls on the party who seeks to maintain a class action. *Amswiss International Corp. v. Heublein, Inc.*, 69 F.R.D. 663, 665 (N.D. Ga. 1975). Questions concerning class certification are left to the sound discretion of the trial court. *Freeman v. Motor Convoy, Inc.*, 700 F.2d 1339, 1347 (11th Cir. 1983).

The question of class certification is a procedural one, distinct from the merits of the action. *Garcia v. Gloor*, 618 F.2d 264, 267 (5th Cir. 1980), *cert. denied*, 449 U.S. 1113, 101 S.Ct. 923, 66 L.Ed.2d 842 (1981). The court may not inquire into the merits of this case because the Supreme Court has held that "nothing in either the language or history of Rule 23 . . . gives a court any authority to conduct a preliminary inquiry into the merits of a suit in order to determine whether it may be maintained as a class action." *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 177, 94 S. Ct. 2140, 2152, 40 L.Ed.2d 732 (1974). "[T]he question is not whether the plaintiff or plaintiffs have stated a cause of action or will prevail on the merits, but rather whether the requirements of Rule 23 are met." *Id.* at 178, 94 S. Ct. at 2153.[8]

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[7] In *Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981)(*en banc*), the Eleventh Circuit adopted the law of the Fifth Circuit prior to October 1, 1981, as binding precedent.

[8] After citing *Eisen*, however, Professor Arthur Miller points out that "there is no way the judge can make the . . . findings required by Rule 23 without

*(Footnote continued)*

The court must make seven affirmative findings before this case may be certified as a class action. First, the plaintiffs must establish two prerequisites not expressly stated in Rule 23 that have been developed by the courts. Then, the plaintiffs must demonstrate that they have met the requirements of Rule 23(a). Finally, the plaintiffs must prove that these cases fall within one of the three categories of class actions in Rule 23(b).

Although not specifically mentioned in Rule 23, the first essential prerequisite of a class action is that there must be a class. 7 C. Wright & A. Miller, *Federal Practice and Procedure: Civil* § 1760 at 579 (1972). The class action complaints allege that these actions were brought on behalf of individuals who purchased, reinvested in, or acquired limited partnership interests in Petro-Lewis income programs from January 1, 1981, to February 6, 1984. These individuals form the class. Once a court determines that a class exists, it then must ascertain whether the named representatives are members of the class they purport to represent. *Id.* at § 1761, at 584; *see East Texas Motor Freight v. Rodriguez*, 431 U.S. 395, 403, 97 S. Ct. 1891, 1896, 52 L.Ed2d 453 (1976)(holding that "a class representative must be part of the class and 'possess the same interest and suffer the same

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at least a preliminary exploration of the merits. This will not be to ascertain who is going to win and who is going to lose, but simply to develop some feel for the contours of the case." A. Miller, *An Overview of Federal Class Actions: Past, Present and Future*, 15 (Federal Judicial Center 2 ed. 1977). The Eleventh Circuit agrees with Miller:

> While it is true that a trial court may not properly reach the merits of a claim when determining whether class certification is warranted, *Miller v. Mackey International, Inc.*, 452 F.2d 424, 428 (5th Cir. 1971), this principle should not be talismanically invoked to artifically limit a trial court's examination of the factors necessary to a reasoned determination of whether a plaintiff has met her burden of establishing each of the Rule 23 class action requirements. *Love v. Turlington*, 733 F.2d 1562, 1564 (11th Cir. 1984).

injury' as the class members"). Because the plaintiffs clearly purchased their limited partnership interests within the class period, they are clearly members of the class.

Having satisfied the two implied prerequisites for a class action, the plaintiffs have the burden of making a positive showing that they fulfill all the requirements of Rule 23(a) and that the action falls within one of the categories of Rule 23(b). *See Amswiss International Corp. v. Heublein, Inc.*, 69 F.R.D. 663, 665-66 (N.D. Ga. 1975). The court now turns to Rule 23.

## IV. RULE 23(a)

A class action "may only be certified if the trial court is satisfied, after a rigorous analysis, that the prerequisites of Rule 23(a) have been satisfied." *General Telephone Co. of the Southwest v. Falcon*, 457 U.S. 147, 161, 102 S. Ct. 2364, 2372, 72 L.Ed.2d 740 (1982). Rule 23(a) provides:

> *Prerequisites to a Class Action.* One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

The court addresses each of these subdivisions in turn.

### A. *Rule 23(a)(1): Numerosity*

Numerosity is not in dispute in this case. Joinder of all class members clearly would be impracticable. A plaintiff need not specify an exact number of class members, but must show only that joinder is impracticable through "some evidence or reasonable estimate of the number of purported class members." *See Zeidman v. J. Ray McDermott & Co.*, 651 F.2d 1030, 1038

(5th Cir. 1981). The plaintiffs in *Kirkpatrick* and *Sanders* have offered evidence showing that there are approximately 8,000 individuals who are potential class members. None of the defendants contends that the plaintiffs have not met the numerosity requirement.

B. *Rule 23(a)(2): Commonality*

To satisfy Rule 23(a)(2) the plaintiff must establish the existence of questions of law *or* fact common to the class. This provision does not require that all class members share the exact same legal claims. *Johnson v. American Credit Co. of Georgia*, 581 F.2d 526, 532 (5th Cir. 1978). The commonality requirement is satisfied where the questions of law or fact linking the class members are substantially related to the resolution of the litigation even though the individuals are not identically situated. *See Kleiner v. First National Bank of Atlanta*, 97 F.R.D. 683, 691 (N.D. Ga. 1983). The court notes that because Rule 23(a)(2) requires "questions of law or fact," more than one issue of law or fact must be common to the members of the class.

The plaintiffs list numerous questions of law or fact that clearly satisfy this requirement: (1) whether the prospectuses and other sales literature distributed by the defendants to the plaintiffs and the class contain material misrepresentations of fact or omit material facts concerning the safety and investment worth of the Petro-Lewis partnerships; (2) whether, during the class period, the defendants concealed material information about the precarious financial condition of Petro-Lewis and its partnerships; (3) whether the defendants concealed the truth about the historical performance of the Petro-Lewis partnerships; (4) whether the defendants misrepresented the future business prospects of Petro-Lewis and its partnerships programs; and (5) whether the defendants violated the federal securities laws and the common law in connection with their sales of limited partnership interests in the Petro-Lewis programs during the class period.

In most cases, neither the parties nor the courts spend much time discussing the commonality requirement. In general, courts

that have focused on Rule 23(a)(2) have given it a permissive application so that common questions have been found to exist in a wide range of contexts. 7 C. Wright & A. Miller, *Federal Practice and Procedure: Civil* § 1763 at 604 (1972).[9]

### C. *Rule 23(a)(3): Typicality*

Rule 23(a)(3) insists that the class representatives have typical claims or defenses.[10] A representative's claim is typical of the class if it arises from the same event, practice, or course of conduct that gives rise to the claims of the absent class members and if the individual claims are based on the same legal or remedial theory. *Davis v. Northside Realty Associates, Inc.*, 95 F.R.D. 39, 43 (N.D. Ga. 1982); *see Gonzales v. Cassidy*, 474 F.2d 67, 71 n.7 (5th Cir. 1973)(holding that representative was "typical of the class within the meaning of Rule 23(a)(3) because he did not have interests which conflicted with those of the class, . . ."). The Supreme Court has held that typicality is met when a "class representative [is] part of the class and 'possess[es] the same interests and suffer[s] the same injury' as the class members." *East Texas Motor Freight System, Inc. v. Rodriguez*, 431 U.S. 395, 403, 97 S. Ct. 1891, 1896, 52 L.Ed.2d 453 (1976).

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[9] It is important to distinguish between Rule 23(a)(2) and Rule 23(b)(3). Rule 23(b)(3) provides that common questions must *predominate* to have a class action under Rule 23(b)(3). This requirement is discussed more fully in part V.

[10] Professor Arthur Miller is skeptical about the usefulness of this requirement:

> But in the case of subdivision (a)(3), there does not seem to be *any* function it performs that is not accomplished by some other portion of the Rule. . . . But if the plaintiffs are class members (an implied requirement), and there are common questions (Rule 23(a)(2)), and the class is adequately represented (Rule 23(a)(4)), it is very, very difficult to identify anything that is added by "typicality." The other prerequisites will ensure "typicality" among the class members' claims or defenses.

A. Miller, *An Overview of Federal Class Actions: Past, Present and Future*, 26 (Federal Judicial Center 2 ed. 1977) (emphasis in original).

The degree of investment experience or sophistication of the class representatives is irrelevant. *Kennedy v. Tallant*, 710 F.2d 711, 717 (11th Cir. 1983). The complaints allege that the defendant committed the same unlawful acts by the same method against an entire class. All members of the class, therefore, may have similar claims. Thus, the plaintiffs have met the typicality requirement. *See id.* Even though class members purchased different Petro-Lewis limited partnership interests, the plaintiffs allege that the defendants engaged in a uniformly fraudulent course of conduct, disseminated virtually identical false prospectuses, financial statements, and other financial information, and failed to disclose material information regarding the operations of Petro-Lewis to purchasers during the class period. When plaintiffs have alleged such a common course of conduct, courts consistently have found no bar to class certification even though members of a class may have purchased different types of securities or interests, or purchased similar securities at different times.

When weighing the prerequisites of Rule 23, the Eleventh Circuit has held that "subsection (a)(3) primarily directs the district court to focus on whether named representatives' claims have the same essential characteristics as the claims of the class at large. Moreover, "the typicality requirement may be satisfied even if there are factual distinctions between the claims of the named plaintiffs and those of other class members." *Appleyard v. Wallace*, 754 F.2d 955, 958 (11th Cir. 1985)(citations omitted). The court clearly finds that the plaintiffs' claims are typical of the classes they seek to represent. "[T]he typicality requirement is not so rigid as to comprehend only similar fact situations . . . it would be a better test of typicality to consider whether the types of facts or evidence were typical of the class." *Walker v. Jim Dandy Co.*, 638 F.2d 1330, 1336 (5th Cir. 1981).

D. *Rule 23(a)(4): Adequacy of Representation*

Rule 23(a)(4) is the most important prerequisite in Rule 23(a). *See* A. Miller, *An Overview of Federal Class Actions: Past, Present and Future*, 27 (Federal Judicial Center 2 ed. 1977). This provision requires a showing that the class representative will

fairly and adequately protect the interests of the class. By far it is the most heavily litigated of the prerequisites. *Id.* at 28. Professor Miller states:

> The class or representative action represents an exception to the principle of an individual right to a day in court. The justification for permitting it is that considerations of efficiency and economy and good practice permit issuing an order or rendering a judgment that binds everyone in a defined group who was properly represented before the court and therefore has had a day in court vicariously. It is Rule 23(a)(4) that ensures the quality of that representation and the integrity of the system. Unless there has been fair and adequate representation, due process has not been satisfied and any attempt at binding the absentee is improper. *Id.*

*See Hansberry v. Lee*, 311 U.S. 32, 44-46, 61 S. Ct. 115, 119-20, 85 L.Ed. 22 (1940)(discussing due process under Rule 23(a)(4)).

Courts traditionally hold that to satisfy Rule 23(a)(4) the plaintiff must meet two tests. First, the plaintiff's attorney must be qualified, experienced, and generally able to conduct the proposed litigation. *Gonzales v. Cassidy*, 474 F.2d 67, 73 n.10 (5th Cir. 1973); *Schatzman v. Talley*, 91 F.R.D. 270, 273 (N.D. Ga. 1981). Based on the plaintiffs' attorneys' performance in these cases thus far, as seen through the discovery, briefs, and motions, and the hearing before the court, the court has no reason to question the competency of the plaintiffs' attorneys. They have demonstrated a clear understanding of the issues in these cases and the competence and ability to conduct sophisticated securities litigation.

The second requirement under Rule 23(a)(4) is that the plaintiffs must not have interests antagonistic to those of the class. *Gonzales*, 474 F.2d at 73 n.10; *Schatzman*, 91 F.R.D. at 373. Courts interpreting this prerequisite have held that "the primary criterion is the forthrightness and the vigor with which the representative party can be expected to assert and defend the

interests of the members of the class." *See Schatzman*, 91 F.R.D. at 273. The named plaintiffs have failed to impress the court that they will vigorously prosecute these class actions. The representatives are not sufficiently interested in the outcome of these actions to protect adequately the rights of the potential class members. The plaintiffs' failure in this respect is fatal to their motions for class certification.

The court notes that while each of the reasons given below is not determinative, the "totality of the circumstances" indicates that the plaintiffs have failed to satisfy Rule 23(a)(4).

> First, in the hearing the court stated: It concerns me deeply today that as far as I know none of the named plaintiffs showed up for this hearing and in fact when a subpoena was issued for them they resisted. I did not require them to appear simply because I thought if they were interested in the litigation they ought not to have to be subpoenaed to appear. Transcript of hearing, Feb. 27, 1986, at 114-15.

The plaintiffs contend that the defendants subpoenaed the plaintiffs merely to harass them. At the hearing, the court was not concerned with the potential for harassment, but rather with the plaintiffs' reluctance to vigorously prosecute these class actions. The plaintiffs' failure to show up for the hearings indicates a lack of interest.

Second, the plaintiffs cannot act as representatives for the state and common law claims because these claims vary from state to state. In addition, different state statutes of limitation govern the section 10(b) claims. These differences are discussed more fully in part V, sections C and D.

In *Sanders*, Glenn Sanders stated that he had little or no involvement in preparing the complaint, which was investigated and drafted exclusively by his attorneys. Deposition of Glenn Sanders, pp. 85-86, 92-93. Sanders also was uncertain whether to proceed with this action if the class was not certified. *Id.* at

p. 114. Sanders did not know the identity of the individual defendants named in the complaint. *Id.* at pp. 94-96.

Leslie Sanders, the other named plaintiff in the *Sanders* case, indicated that she did not want to be involved in this case and did not agree to become one of the named plaintiffs until counsel for the plaintiffs called her one month before her deposition. Deposition of Leslie Sanders, pp. 49-52. Ms. Sanders did not contribute to the complaint or the amended complaint, and she never saw the amended complaint until a couple of days before the deposition. *Id.* at p. 50. In addition, Ms. Sanders did not know the name of one of the firms that was representing her. *Id.* at p. 3. Furthermore, Ms. Sanders stated that her claim does not concern her initial decision to purchase securities, as the complaint alleges, but that in 1983 Robinson-Humphrey purportedly told her not to sell her securities. *Id.* at pp. 43, 54. Ms. Sanders also did not know the identity of the individual defendants. *Id.* at pp. 55-56. Chip Traynor, the broker who allegedly fraudulently sold securities to Ms. Sanders, still acts as a broker for her and almost all her family. Deposition of Chip Traynor, p. 232. If the Sanders truly felt that their broker defrauded them, presumably he would no longer be their broker.

In *Kirkpatrick*, plaintiff Charles Lindsey purchased limited partnership interests through his brother, a broker for J.C. Bradford. In deposition, Lindsey stated:

> Q. Is it your belief that they [the defendants] tried to defraud the investing public, or do you think they're just guilty of mismanagement, or do you have--
>
> A. I don't know. I don't think you can say that somebody was really planning to defraud me. Petro-Lewis was a reputable firm and was on the New York Stock Exchange and what have you. Petro-Lewis is not a fly-by-night. I mean, they were a pretty reputable firm. I don't think Bradford's people kept up with it. That's pure and simple what happened.

Q. You think they were negligent?

A. Absolutely, positively....

Deposition of Charles Lindsey, pp. 60-61. Lindsey was careful to point out that the allegations of paragraph 5 of the complaint — to the effect that he purchased pursuant to a prospectus — were in error. While insisting that he would let the chips fall where they might against his brother, Lindsey admitted that his family would be upset if he sued his brother. *Id.* at p. 57.

Similarly, plaintiff Suzanne Kirkpatrick still has an account with the person from whom she purchased her partnership interests in Petro-Lewis, although he no longer works for J. C. Bradford. Deposition of Suzanne J. Kirkpatrick, p. 6. In her deposition, Kirkpatrick stated:

Q. ...Is it your belief or your contention that Bradford was trying to defraud you or was trying to sell you something they knew or should have known was no good?

A. No, sir, but I think they should have done their homework before they made the sales.

Q. You think they were negligent in failing to find this out?

A. Yes.

*Id.* at p. 69.

The other named plaintiff in *Kirkpatrick*, Dorothy Casler, purchased her interests in Petro-Lewis from her son. In deposition, she testified:

Q. Have you sued your son over his selling you this Petro-Lewis?

A. No.

> Q. Well, you sued Bradford and I was wondering if you sued him since he's the one that put you into it?
>
> A. No.
>
> Q. Is there any reason why you haven't?
>
> A. Because I think he – in his mind he thought it was the best thing that I could do.

Deposition of Dorothy Casler, p. 8. In addition, Casler's son did not disclose to her the risks which, as the complaint alleges, were disclosed in the prospectus concerning a possible decline in the price of oil and the fact that Petro-Lewis was borrowing money to make the property acquisitions. *Id.* at pp. 48-49. In fact, Casler says she thought there were virtually no risks involved because her son knew that she could not take risks. *Id.* at p. 38. Casler expressed shock at the possibility that her claim might give rise to a lawsuit against her son. *Id.* at p. 42.

In summary, the court finds that the plaintiffs in their deposition testimony in *Sanders* and *Kirkpatrick* demonstrate a lack of interest in the vigorous prosecution of this lawsuit. Glenn and Leslie Sanders are not involved or knowledgeable enough to effectively prosecute a class action. *See Schatzman v. Talley*, 91 F.R.D. 270, 273 (N.D. Ga. 1981). The plaintiffs in *Kirkpatrick* do not believe, or are unwilling to prosecute, their fraud claims. For these reasons, the plaintiffs would not fairly and adequately represent the other class members. *See Rothenberg v. Security Management Co.*, 667 F.2d 958, 962-63 (11th Cir. 1982).

## V. RULE 23(b)

If the four prerequisites of Rule 23(a) are satisfied, a suit may be maintained as a class action only if it falls within one of the three categories set forth in Rule 23(b). *See George v. United Federal Savings and Loan Association*, 63 F.R.D. 631, 636 (N.D. Ga. 1974). Even assuming that the plaintiffs satisfy Rule 23(a)(4), the court holds that they cannot satisfy Rule 23(b).

Rule 23(b) prescribes the various types of class actions that are permitted under the Federal Rules. It provides:

> (b) *Class Actions Maintainable.* An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:
> (1) the prosecution of separate actions by or against individual members of the class would create a risk of
> (A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or
> (B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or
> (2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or
> (3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

At the outset, the court notes that the parties do not rely on or discuss Rule 23(b)(1) or (b)(2). Because the plaintiffs do not

allege that these subdivisions apply, [a] the court turns to subdivision (b)(3).

Rule 23(b)(3) sets out two prerequisites that the plaintiffs must satisfy to maintain a class action under this subdivision: (1) questions of law or fact common to the members of the class must *predominate* over any questions affecting only individual members; and (2) the class action must be superior to other available methods for the fair and efficient adjudication of the controversy. A plaintiff must satisfy Rule 23(b)(3) to have a class action that involves securities fraud.

The court holds that because common questions of law and fact do not predominate, the plaintiffs cannot satisfy Rule 23(b)(3). The court arrives at this conclusion for four reasons. First, and most importantly, the alleged statements upon which the plaintiffs relied in purchasing Petro-Lewis securities were primarily oral rather than written and misrepresentations rather than omissions. The court, therefore, cannot imply the element of reliance central to the issue of this case. "[T]he most significant problem facing the [class] representatives under subdivision (b)(3) is to demonstrate that the representations made to and the reliance by each of the class members is not so divergent that common questions do not predominate." 7A C. Wright & A. Miller, *Federal Practice and Procedure: Civil*, § 1781 at 90 (1972). The plaintiffs have failed to overcome this problem. Second, many of the potential class members have signed arbitration agreements that oblige them to arbitrate their grievances. Third, the statute of limitations for section 10(b) varies from state to state, and in some states it is unknown. Last, because the purchasers of Petro-Lewis limited partnerships are from most of the 50 states, this court would be forced to apply the state and common law from each state in which a potential class member resides. The court addresses each of these problems in turn.

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[a] The plaintiffs may not rely on Rule 23(b)(2) because this subdivision only applies to injunctive or declaratory relief. "The subdivision does not extend to cases in which the appropriate final relief relates exclusively or predominately to money damages." Rule 23, Notes of Advisory Committee. The plaintiffs seek money damages.

A. *Oral Representations and Reliance*

The principal claims asserted by the plaintiffs are based upon alleged violations of section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934. To support a claim under section 10(b) and Rule 10b-5 the plaintiff must establish the following elements: (1) that a misstatement or omission has been made, (2) that the misstatement or omission pertains to material facts, (3) that the misstatement or omission was made with scienter, (4) that the plaintiff relied upon the misstatement or omission, and (5) that the misstatement or omission was the proximate cause of the injury to the plaintiff. *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981)(*en banc*), *modified on other grounds*, 650 F.2d 815 (1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375, 103 S. Ct. 683, 74 L.Ed.2d 548 (1983). Each of these elements of a section 10(b) and Rule 10b-5 cause of action must be proven for the plaintiff to prevail.

Although a determination of class action generally does not permit investigation into the merits of a case, it is necessary in this situation in order to determine whether the common questions of law or fact predominate over individual questions of law or fact concerning the section 10(b) and Rule 10b-5 claims. The key factor in determining whether class action is appropriate is the matter of reliance. If it is determined that reliance is common to all members of the class, the class action will stand. If, however, reliance is found to be an individual element whereby each plaintiff must prove reliance upon misstatements and omissions, the class action status will not be available.

The element of reliance and its effect upon class certification have been handled by the courts in several different fashions. Reliance may be implied where the plaintiff alleges a course of fraudulent conduct common to all members of the class where misrepresentations or omissions upon which the fraud is based are uniform throughout the class. *In re Home Stake Production Co. Securities Litigation*, 76 F.R.D. 351 (N.D. Okla. 1977). It may be implied where the course of fraudulent conduct is perpetrated by way of oral representations where information material to the decision to purchase has been omitted.

*Affiliated Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L.Ed.2d 741 (1972); *Kennedy v. Tallant*, 710 F.2d 711 (11th Cir. 1983); *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981)(*en banc*), *cert. denied*, 459 U.S. 1102, 103 S Ct. 722, 74 L.Ed.2d 949 (1983). Finally, reliance may be implied under the "Fraud on the Market" theory. *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984).

In an attempt to refute the requirement of reliance, the plaintiffs allege the following: (1) that the defendants have perpetrated a course of fraudulent conduct upon all members of the proposed classes by use of a uniform sales pitch in marketing Petro-Lewis securities, (2) that this is not a case of oral misrepresentations and omissions but one of written misrepresentations and omissions found in the prospectuses and other written materials issued by Petro-Lewis, and (3) that the defendants have perpetrated a "Fraud on the Market" with regard to Petro-Lewis securities.

The court finds that none of these allegations falls within the bounds required for implying the element of reliance necessary to justify class certification in a section 10(b) and Rule 10b-5 action.

The plaintiffs state that the defendants followed a fraudulent course of conduct in making sales of Petro-Lewis securities to the potential class members and rely upon *Kennedy* and *Home Stake* to support these allegations. A distinction must be made, however, between these two cases and the instant case. First, the suits in *Home Stake* and *Kennedy* were brought against the company issuing the securities involved rather than against the broker selling the securities. Second, the securities in *Home Stake* and *Kennedy* were sold by salesmen employed by the company issuing the securities rather than by brokerage firms promoting sales between the issuer and the purchaser as in the instant case. In circumstances such as those in *Home Stake* and *Kennedy*, the issuer has direct control over what information is disseminated to the purchasers as well as control over the means by which the information is transferred. In *Home Stake*, for instance, the issuer had a sales force promoting sales by use of a "black book," which was the central selling tool in each

presentation. The plaintiffs in the instant cases allege that a uniform sales program was used in presentations to prospective buyers who are potential class members. However, all the briefs, as well as information in the complaint, presented by the plaintiffs in support of a class action status assert facts pertinent only to the sales pitch by Petro-Lewis to each of the individual brokerage houses. Granted, the defendants could have used the sales materials presented by Petro-Lewis (and in the case of plaintiff Parker, did by way of a joint seminar presented by Petro-Lewis and Paine Webber). However, the plaintiffs have presented no materials whatsoever, developed through discovery or asserted by the individual plaintiffs, indicating a uniform presentation or "sales pitch" by the defendants to all the members of the proposed classes. Had the plaintiffs shown evidence of the uniform sales pitch by each of the defendants to the members of the proposed classes, then a fraudulent course of conduct by the defendants might be at issue and class action status might be warranted. The sales suggestions presented by Petro-Lewis to the defendant brokerage firms provide no guarantee that the brokerage firms would use the sales materials provided. The plaintiffs have failed to show that the materials provided were in fact used on a uniform basis or used at all by the defendants. The alleged common course of conduct was conduct between Petro-Lewis and the defendants rather than the defendants and the plaintiffs and cannot form the basis for dispensing with the reliance required in a section 10(b) and Rule 10b-5 action. Hence, the uniform scheme required to assume the element of reliance has not been alleged.

The plaintiffs contend that the defendants misrepresented and omitted certain facts from presentations made in sales of the Petro-Lewis securities and rely upon the prospectuses as the uniform sales tool used in the misrepresentations and omissions. The named plaintiffs acknowledge that they either did not read the prospectuses and relied entirely upon the information provided by their brokers,[a] or state that they read or looked through

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[a] In *Sanders v. Robinson-Humphrey*, both plaintiffs stated that they did not read the prospectus and in fact relied totally upon oral representations by their

*(Footnote continued)*

the prospectuses, but could not recall any specifics and also relied upon representations made by their brokers in deciding to purchase the Petro-Lewis partnership interests.[8] The plaintiffs assert that because the prospectuses were used in the sales of the securities, the misrepresentations and omissions presented in them provide a uniform presentation upon which common reliance can be based, and class certification need not depend upon whether the plaintiffs actually read the prospectuses. *Kennedy v. Tallant*, 710 F.2d 711 (11th Cir. 1983); *Affiliate Ute Citizens of Utah v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L.Ed.2d 741; *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981)(*en banc*), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722, 74 L.Ed.2d 949 (1983); *Sharp v. Coopers & Lybrand*, 70 F.R.D. 544 (E.D. Pa. 1976). If misrepresentations are both oral and written and the plaintiffs relied upon the oral representations of their brokers, there is no standardized communication by the defendants and no basis for the assumption of reliance. *Simon v. Merrill Lynch*,

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brokers. *See* Deposition of Glenn Sanders, pp. 28-32, 35-36, 42, 46-49, 51-56; deposition of Leslie Sanders, pp. 19-29, 24-26, 31-32, 46. In *Kirkpatrick v. J.C. Bradford*, plaintiff Suzanne Kirkpatrick did not read a prospectus until after she made her purchase, deposition of Suzanne Kirkpatrick, p. 38, and relied totally upon J.C. Bradford's remarks concerning the Petro-Lewis investment. *Id.* at pp. 71-72. Plaintiff Dorothy Casler relied totally on her son, a broker for J.C. Bradford, in making her decision to purchase. Deposition of Dorothy Casler, pp. 35-36. As to plaintiff Charles Lindsey, Mr. Lindsey invested through his brother and relied totally upon what his brother told him. Deposition of Charles Lindsey p. 8.

[8] In *Parker v. Paine Webber*, both plaintiffs state that they looked at the prospectus. However, James Smith did not review the prospectus until after his first purchase of Petro-Lewis securities, deposition of James S. Smith, pp. 193-94, and when he finally did review the prospectus, was unable to point to specifics in the prospectus. When asked which portions of the prospectus were false and misleading, Mr. Smith stated, "I'm not able to do that, because it was an overall impression I got after talking to my broker, after this (indicating), it was may overall impression of the investment rather than the specifics from this document." *Id.* at p. 234. When Mr. Parker was questioned about reading the prospectus he stated, "I reviewed the prospectus. To be frank, you know, I was more interested in the pamphlet they had with all the pretty pictures in it." Deposition of Tommy E. Parker, p. 123. Smith later stated that in making his decision to purchase he relied on what Petro-Lewis and his broker said at the seminar which Mr. Parker attended. *Id.* at p. 39.

*Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973). The distinction here is that the cases relied upon by the plaintiffs were omissions cases whereas the instant cases primarily involve misrepresentations. The allegations stated in the complaints are almost entirely allegations of misrepresentations of material information presented in the prospectuses rather than the omission of material facts in the sale of Petro-Lewis securities. Where the misrepresentations and omissions are oral, precluding the uniformity of sales, rather than written, the court may infer reliance by the plaintiff in a section 10(b) and Rule 10b-5 action only where the defendant fails to disclose information material to the sale of the security. Where failure to disclose is material, the case is an omissions case. *Affiliated Ute*, *supra*; *Huddleston v. Herman & MacLean*, 640 F.2d 534 (5th Cir. 1981) (*en banc modified on other grounds*, 650 F.2d 815 (1981), *aff'd in part and rev'd in part on other grounds*, 459 U.S. 375, 103 S. Ct. 683, 74 L.Ed.2d 548 (1983)); *Simon*, *supra*; *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981). "Where a 10b-5 action alleges defendant made positive misrepresentations of material information, proof of reliance by the plaintiff upon misrepresentations is required. Upon an absence of proof on the issue, plaintiff loses. On the other hand, where a plaintiff alleges deception by defendant's nondisclosure of material information, the *Ute* presumption obviates the need for plaintiff to prove actual reliance on the omitted information." *Rifkin v. Crow*, 574 F.2d 256, 262 (5th Cir. 1978) (footnote omitted).

This court has determined that the instant case is primarily one of a "misstatement or failure to state the facts necessary to make those statements made not misleading." *Huddleston*, 640 F.2d at 548. Because this case is one of misrepresentation, it is necessary that each class member prove his individual reliance upon the material misrepresentations made to him. Certification as a class action, therefore, is highly inappropriate. *Cavalier Carpets, Inc. v. Caylor*, 746 F.2d 749 (11th Cir. 1984); *Huddleston*, *supra*.

The plaintiffs' final attempt to procure a basis for the assumption of reliance is based upon the Fraud on the Market theory.

If the Fraud on the Market theory is accepted by the court, the element of reliance in a section 10(b) and Rule 10b-5 action is assumed because the reliance is based upon the integrity of the open market and sales of the security on the open market. *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984). This court has recognized the Fraud on the Market theory in *Shores* and *Lipton*, but has applied the theory only to securities traded on the open market. Although *Shores* involved the sales of new issue bonds, the bonds were traded on the secondary market after the original issue was released. Additionally, the plaintiff in *Shores* alleged that, but for the fraud, the bonds would not have been offered at all. Proof that they would have been issued at a higher or lower price would not have been sufficient for the plaintiff to recover.

The case at bar does not fall under the realm of the Fraud on the Market theory of *Shores* or *Lipton*. In the current action the plaintiffs do not allege that the securities would not have been sold had the misrepresentations not been present, nor have they shown that the securities were sold on the open market at the time of the purchases. The securities in fact were limited partnerships where liquidity was spelled out in the prospectus as being nonexistent except for the ability of Petro-Lewis to repurchase the interest. Petro-Lewis additionally set the price, the number of sales that were to be made, and also looked at the ability of each purchaser to withstand any losses that might result from a purchase of this nature. Hence these securities were not traded on the open market where such factors would not be present. In an open market the issuer would have no contact whatsoever with the purchaser, the issuer would not set the price for sale of the securities, and the issuer would not provide for repurchase of the security in the event the purchaser desired to sell. Moreover, in an open market, in order to sell, the purchaser only would have to set a price for sale of the security and have a broker place the order. These characteristics of an open market are not present in this cause of action. The plaintiffs, therefore, cannot rely upon the Fraud on the Market theory to provide the necessary reliance element of section 10(b) and Rule 10b-5 of the 1934 Act.

The court finds that the plaintiffs have not met the reliance requirement of section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 and, therefore, cannot meet the predominance requirement of Rule 23(b)(3). This is an oral misrepresentation case and because the reliance requirement cannot be implied, each member of the class would be required to prove his reliance upon the misrepresentations and omissions in the purchase of Petro-Lewis securities.

### B. *Arbitration*

In addition to the requirement of predominance of common issues over individual issues, Rule 23(b)(3) requires that the class action be "superior to other available methods for the fair and efficient adjudication of the controversy." At issue in both of these contexts is the right of the defendants to enforce arbitration agreements with members of the proposed classes. Each defendant has available the arbitration forum with some members of the proposed classes.[14]

As to all state claims where defendants have executed an arbitration agreement with purchasers of Petro-Lewis securities who fall into the proposed classes, it has been determined that the "Arbitration Act requires district courts to compel arbitration of pendent arbitrable claims where one of the parties files a motion to compel, even where the result would be the possible inefficient maintenance of separate proceedings in different forums." *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 1241, 84 L.Ed.2d 158 (1985). Should any of the defendants move to arbitrate any of the class members' claims where a valid arbitration agreement is in existence, the court

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[14] Each of the defendants has alleged the existence of arbitration agreements with some members of the proposed classes. Although defendants Paine Webber and J.C. Bradford and Co. have not indicated the numbers that could be potentially involved in arbitration, Robinson-Humphrey has stated that those class members that could reach arbitration are between 50 and 70 percent of the total number of potential class members in the *Sanders v. Robinson-Humphrey* action.

would be required to compel arbitration and stay the current proceedings until such time as the arbitration is completed with regard to the state issues involved therein. *See Harris v. Shearson Hayden Stone, Inc.*, 82 A.D.2d 87, 441 N.Y.S.2d 70 (1981), *aff'd*, 56 N.Y.2d 62, 450 N.Y.S.2d 482, 435 N.E. 2d 1097 (1982); *Vernon v. Drexel Burnham & Co.*, 52 Cal.App. 3d 706, 125 Cal. Rptr. 147 (1975). Such a situation would be untenable, particularly in *Sanders*, where upwards of 70 percent of the proposed class members have executed arbitration agreements.

The plaintiffs assert that, because the Securities Act of 1933 is part of the litigation, arbitration of the federal claims is not enforceable. The 1933 Act claims are not subject to arbitration. *Wilko v. Swan*, 346 U.S. 427, 74 S. Ct. 182, 98 L.Ed. 168 (1953). However, the 1933 Act claims do not comprise the major issues in these cases. The plaintiffs contend that the claims under section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934 are also not subject to arbitration pursuant to the Eleventh Circuit ruling in *Gorman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 780 F.2d 1032 (11th Cir. 1985). That case, however, is now *en banc* and no longer binding upon this court. This court is of the opinion, as stated in *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Civil Action No. C83-685A (N.D. Ga. May 16, 1985), and *Chandler v. Drexel Burnham Lambert, Inc.*, 633 F.Supp. 760 (N.D. Ga. 1985), that the 1934 Act claims are subject to the Arbitration Act and to arbitration agreements executed by the defendants and potential class members and must be sent, along with any state claims, to arbitration upon motion by the defendants. This opinion is supported by a number of recent Supreme Court cases including *Byrd, Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), and *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____U.S.____, 105 S. Ct. 3346, 87 L.Ed.2d 444 (1985). The Supreme Court has established a strong tendency to favor use of the arbitration forum in the context of federal statutory claims. Indeed, in *Mitsubishi* the Court stated:

> We find no warrant in the Arbitration Act for implying in every contract within its ken a presumption against

> arbitration of statutory claims. . . . Nor is there any reason to depart from the federal policy favoring arbitration where a party bound by an arbitration agreement raises claims founded on statutory rights. *Mitsubishi,* 105 S. Ct. at 3355.

This policy favoring the arbitration agreement is based upon the " 'preeminent concern . . . to enforce private agreements into which parties had entered,' a concern which 'requires that we rigorously enforce agreements to arbitrate.' " *Id.* at 3356, citing *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 105 S. Ct. 1238, 1243, 84 L.Ed.2d 158 (1985).

In conjunction with the strong tendency of the courts to favor enforcement of arbitration agreements is the express provision in 28 U.S.C. § 2072 of the enabling act of the Federal Rules of Civil Procedure whereby Congress stated that the "rules shall not abridge, enlarge, or modify any substantive right . . . " Rule 23 is a procedural device provided by Congress to allow the court discretion in applying class action status to plaintiffs and those other class members similarly situated. The right to arbitration is contractual and therefore substantive. Congress did not intend that procedural class action certification be used to abrogate the contractual rights employed in the execution of the arbitration agreements by the defendants and some members of the proposed classes. To allow class certification where such arbitration agreements exist would not only be unduly burdensome and inefficient should defendants move to compel arbitration but would also violate the requirement of Rule 23(b)(3) that the class action be "superior to other available methods for the fair and efficient adjudication of the controversy." Fed. R. Civ. P. 23(b)(3).

### C. *Rule 10b-5 Statute of Limitations*

Although the moment at which a section 10(b) action accrues and the statute of limitations begins to run is a matter of federal law, the time period itself is taken from state law. *Kennedy v. Tallant*, 710 F.2d 711, 716 (11th Cir. 1983). Under *Phillips Petroleum Co. v. Shutts*, ___ U.S. ___, 105 S. Ct. 2965, 2980, 86 L.Ed.2d 628 (1985), this court "may not take a transaction with little or no relationship to [Georgia] and apply [Georgia law]

in order to satisfy the procedural requirement that there be a 'common question of law.' " If the court certifies these class actions, it must apply the state statute of limitations for every state in which a class member resides. This court has held that where "the applicable statute of limitations . . . is dependent on state law . . . [the claims] are inappropriate for treatment as class actions because they present substantial and predominate [*sic*] individual questions." *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979).

The time period within which a section 10(b) action must be brought varies from state of state. Courts have applied a one-year statute of limitations, *see, e.g., O'Hara v. Kovens*, 625 F.2d 15, 17 (4th Cir. 1980), *cert. denied*, 449 U.S. 1124, 101 S.Ct. 939, 67 L.Ed.2d 109 (1981) (Maryland); a two-year statute of limitations, *see, e.g., Diamond v. Lamotte*, 709 F.2d 1419, 1424 (11th Cir. 1983) (Georgia); *Gurley v. Documation, Inc.*, 674 F.2d 253, 259 (4th Cir. 1982) (Virginia); *White v. Sanders*, 650 F.2d 627, 633 (5th Cir. 1981) (Alabama); *Cook v. Avien, Inc.*, 573 F.2d 685, 694 (1st Cir. 1978) (Massachusetts); *Dupuy v. Dupuy*, 551 F.2d 1005, 1024 n.31 (5th Cir.), *cert. denied*, 434 U.S. 911, 98 S.Ct. 312, 54 L.Ed.2d 197 (1977) (Louisiana); *Nortek v. Alexander Grant & Co.*, 532 F.2d 1013, 1015 (5th Cir. 1976), *cert. denied*, 429 U. S. 1042, 97 S.Ct. 742, 50 L.Ed 2d 742 (1977) (Florida); *Dirksen v. Hynes & Howes Insurance Counselors, Inc.*, 423 F. Supp. 1290, 1293 & n.4 (S.D. Iowa 1976) (Iowa); a three-year statute of limitations, *see, e.g., Herm v. Stafford*, 663 F.2d 669, 677-78 (6th Cir. 1981) (Kentucky); *Jablon v. Dean Witter & Co.*, 614 F.2d 677, 682 (9th Cir. 1980) (California); *Nemkov v. O'Hare Chicago Corp.*, 592 F.2d 351, 355 (7th Cir. 1979) (Illinois); *Hilton v. Mumaw*, 522 F.2d 588, 601 (9th Cir. 1975) (Washington); *Burns v. Ersek*, 591 F. Supp. 837, 839 (D. Minn. 1984) (Minnesota); *Mid-Carolina Oil, Inc. v. Klippel*, 526 F. Supp. 694, 697 (D. S.C. 1981), *aff'd. mem.*, 673 F.2d 1313 (4th Cir.), *cert. denied*, 457 U.S. 1107, 102 S.Ct. 2906, 73 L.Ed.2d 1315 (1982) (South Carolina); *Ohio v. Peterson, Lowry, Rall, Barber & Ross*, 472 F. Supp. 402, 405-06 (D. Colo. 1979), *aff'd*, 651 F.2d 687 (10th Cir.), *cert. denied*, 454 U.S 895, 102 S. Ct. 392, 70 L.Ed.2d 209 (1981) (Colorado); a four-year statute of

limitations, *see, e.g., Gaudin v. KDI Corp.*, 576 F.2d 708, 711-12 (6th Cir. 1978) (Ohio); and six-year statute of limitations, *see, e.g., Roberts v. Magnetic Metals Co.*, 611 F.2d 450, 452 (3d Cir. 1979) (New Jersey); *IDS Progressive Fund, Inc. v. First of Michigan Corp.*, 533 F.2d 340, 344 (6th Cir. 1976) (Michigan); *Bartels v. Algonquin Properties Ltd.*, 471 F. Supp. 1132, 1147, 1149 (D. Vt. 1979) (Vermont).

In Hawaii, North Dakota, South Dakota, West Virginia, and Wyoming courts have not yet determined the applicable statute of limitations in a section 10(b) case. If this court were to certify a class, it would have to make that determination if a class member resided in one of these states.[15] In several states, the courts have applied different statutes of limitation. For example, in Connecticut the statute of limitations may be two years or three years. *Compare Clute v. Davenport Co.*, 584 F. Supp. 1562, 1577 (D. Conn. 1984) (two years) *with Klock v. Lehman Bros. Kuhn Loeb, Inc.*, 584 F. Supp. 210, 215-16 (S.D.N.Y. 1984) (holding Connecticut law has three-year statute of limitations). Nevada has a three-year limitation period for fraud, a two-year Blue Sky limitation period for fraud in the sale of securities, and a catch-all limitation period of four years. *See* Nev. Rev. Stat. §§ 11.190, 11.220, 90.200. This court, therefore, would have to determine which Nevada statute to apply. Finally, in Rhode Island, a court has indicated that either a six-year general statute of limitations or a three-year personal injury statute of limitations may apply. *See Holmes v. Bateson*, 583 F.2d 542, 561-62 (1st Cir. 1978).

If a class were certified, this court would be the first to determine the statute of limitations for 10(b) actions in numerous states. Given that some states never have ruled on the statute of limitations and other states have applied it with inconsistent results, individual questions of law clearly predominate. In

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[15] In *Sanders* the defendants' attorney indicates that his examination of client mailing lists taken from the defendants' business files shows that the defendants sold Petro-Lewis limited partnership interests to clients maintaining addresses in 32 states, the District of Columbia, and West Germany. Supplemental Affidavit of Peter J. Anderson, ¶ 3.

addition, discovery would be necessary to determine what individual brokers told potential class members at a given time, what each and every class member was told by his broker, and what other information these potential class members received and when they received it.

The plaintiffs contend that under the reasoning in *Kennedy v. Tallant*, 710 F.2d 711, 718 (11th Cir. 1983), even if some class members are threatened with a potential statute of limitations defense, that problem would not necessarily defeat the availability of the class action suit. *Kennedy* has no bearing on this case because this court is not refusing to certify the classes simply because some class members are threatened with a potential statute of limitations defense. Rather, the court is holding that under the reasoning in *Phillips Petroleum Co. v. Shutts*, ____U.S.____, 105 S. Ct. 2965, 2980, 86 L.Ed.2d 628 (1985), and *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979), individual questions of law predominate over common questions of law.

D. *State and Common Law Claims*

The final reason that individual questions of law and fact predominate over questions affecting the potential classes is that the state and common law claims – fraud and deceit, negligence and negligent misrepresentation, and fraudulent concealment and breach of fiduciary duty – require that the court apply the law of every state from which a potential class member resides. In *Sanders* the defendants' attorney indicates that his examination of client mailing lists taken from the defendants' business files shows that the defendants sold Petro-Lewis limited partnership interests to clients maintaining addresses in 32 states, the District of Columbia, and West Germany. Supplemental Affidavit of Peter J. Anderson, ¶ 3. J.C. Bradford and Paine Webber are also national brokerage houses. This court indicated in the hearing that it saw no way of managing these class actions if it had to apply the law of 50 different states, as *Phillips Petroleum Co. v. Shutts*, ____U.S.____, 105 S. Ct. 2965, 2980,

86 L.Ed.2d 628 (1985), requires. *See* Transcript of hearing February 27, 1986, at p. 115.

In *Shutts* the Supreme Court held that a court "may not take a transaction with little or no relationship to the forum and apply the law of the forum in order to satisfy the procedural requirement that there be a 'common question of law.' " *Shutts*, 105 S. Ct. at 2980. The Court rejected the Kansas Supreme Court's holding that "in a nationwide class action where procedural due process guarantees of notice and adequate representation were met, the laws of the forum should be applied unless compelling reasons exist for applying a different law." *Id.* at 2981. This court, therefore, would have no choice but to apply the law of each state in which a potential class member resides. In *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979), this court held:

> Plaintiff's allegations of common law fraud raise questions of fact and law under the law of each state in which the class member made a purchase. The complaint alleges that class members reside throughout the county [*sic*]. Considering the size of the potential class to be 8,500 members, it is likely that the claim for relief based upon common law fraud would involve the laws of all 50 states. With no single law governing the entire class, the allegation of common law fraud cannot be shown to warrant class treatment. *See Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880 (5th Cir. 1973); *King v. Sharp*, 63 F.R.D. 60 (N.D. Tex. 1974); *Adise v. Mather*, 56 F.R.D. 492 (D. Col. 1972).

This court is bound by the decision in *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880, 883 (5th Cir. 1973), in which the court held:

> [T]he geographic dispersion of the alleged representations would bring into issue various state common law standards. With no single law governing the

> entire class, common issues of law cannot be shown to warrant Rule 23 treatment.

Numerous courts have followed the reasoning in *Simon* and *Elster*. *See, e.g., Zandman v. Joseph*, 102 F.R.D. 924, 929 (N.D. Ind. 1984) (holding that "common issues would not predominate in that the fraud issues would have to be tried in accordance with the substantive law of the state of each class member."); *Coca-Cola Bottling Co. v. Coca-Cola Co.*, 95 F.R.D. 168, 177-78 (D. Del. 1982) (refusing to certify class action because it would involve applying the law of more than one state); *Seiden v. Nicholson*, 69 F.R.D. 681, 686 (N.D. Ill. 1976) ("Obviously, a common law fraud claim raises issues which are personal to each individual plaintiff and, therefore, not common to the class. Since individual issues predominate on common law fraud claims, . . . these claims should not be certified for class determination."); *In re U.S. Financial Securities Litigation*, 64 F.R.D. 443, 455 (S.D. Cal. 1974) ("The common law fraud claims brought under pendent jurisdiction are also inappropriate because individual questions of law would predominate if it were necessary to canvass the law of every state in which a purchase of debentures was made."). [16]

The plaintiffs contend that the elements of a fraud claim in each state are basically the same. For this reason, they assert, the court would have no difficulty applying the law of each of the 50 states. While this court does not intend to survey the law of fraud in all 50 states, several major differences do exist. For example, in Alabama a plaintiff does not need to prove that the defendant knew that his representation was false or that he intended to make a false representation, *see Fountain-Lowery Enterprises v. Williams*, 424 So.2d 581, 585 (Ala. 1982), while in Florida the defendant must knowingly and purposefully make a false statement, *see Osborne v. Delta Maintenance and*

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[16] Several courts have certified class actions that include common law fraud claims. *See, e.g., Steiner v. Equimark Corp.*, 96 F.R.D. 603, 606 (W.D. Pa. 1983); *Dekro v. Stern Bros. & Co.*, 540 F. Supp. 406, 418 (W.D. Mo. 1982). This court does not agree with and is not bound by the reasoning in these decisions.

*Welding, Inc.*, 365 So.2d 425, 427 (Fla. App. 1978). In Mississippi, Ohio, South Carolina, and Tennessee, a plaintiff must prove that he had the right to rely on the defendant's representations, *see, e.g., Dunn Appraisal Co. v. Honeywell Information Systems*, Inc., 687 F.2d 877, 882 (6th Cir. 1982) (Ohio); *Miller v. Premier Corp.*, 608 F.2d 973, 980 (4th Cir. 1979) (South Carolina); *Edwards v. Travelers Insurance of Hartford, Connecticut*, 563 F.2d 105, 113 (6th Cir. 1977) (Tennessee); *Franklin v. Lovitt Equipment Co.*, 420 So.2d 1370, 1373 (Miss. 1982), while in other states the plaintiff does not need to prove that he had the right to rely on the defendant's statements, *see, e.g., Keck v. Wacker*, 413 F. Supp. 1377, 1383 (E.D. Ky. 1976); *Stone v. Lawyers Title Insurance Corp.*, 554 S.W.2d 183, 185 (Tex. 1977); *Jefferson Standard Life Insurance Co. Hendrick*, 27 S.E.2d 198, 202 (Va. 1943).

A third area in which the requirements of the various states differ in fraud actions is that the element of scienter varies from state to state. Kentucky, Ohio, and Texas require knowledge of falsity or reckless disregard for the truth. *See Dunn Appraisal Co. v. Honeywell Information Systems, Inc.*, 687 F.2d 877, 882 (6th Cir. 1982); *Keck v. Wacker*, 413 F. Supp. 1377, 1383 (E.D. Ky. 1976); *Stone v. Lawyers Title Insurance Corp.*, 554 S.W.2d 183, 185 (Tex. 1977). Georgia and North Carolina require that the defendant knew the representations were false. *See Grant v. Aulicky*, 161 Ga. App. 817, 819, 290 S.E.2d 107, 109 (1982); *Stone v. Martin*, 56 N.C.App. 473, 289 S.E.2d 898, 901-02 (N.C. App. 1982). In Virginia intention is immaterial, *Ware v. Scott*, 220 Va. 317, 257 S.E.2d 855, 857 n.2 (1979), while in Tennessee and South Carolina intention is a necessary element of a fraud action. *See Cumberland Portland Cement Co. v. R.F.C.*, 140 F. Supp. 739, 750 (E.D. Tenn. 1953); *Lancaster v. Smithco., Inc.*, 238 S.C. 15, 119 S.E.2d 145, 145 (1961). In Louisiana, the intention must be either to obtain an unjust advantage for one party or to cause loss or inconvenience to the other. La. Civ. Code Ann. art. 1953 (West 1986).

This brief survey of the law of fraud indicates that this court would have to analyze and interpret the laws of each state

for all three state and common law claims. More importantly, a jury would have to receive a new set of instructions and apply a different standard of law for each state in which a potential class member resides. Clearly, individual questions of law and fact predominate over common questions for these pendent claims.

## VI. SUMMARY

In summary, because the plaintiffs have failed to meet the requirements of Rule 23(a)(4) and Rule 23(b)(3), the motions for class certification are DENIED. The plaintiffs may proceed individually against the defendants but may not represent the proposed classes. Pursuant to Rule 23(d)(4), the court ORDERS that the pleadings be amended to strike all references to class action and the representation of absent individuals.

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

GLENN T. SANDERS, on behalf of himself and all others similarly situated,

*Plaintiffs,*

vs.

ROBINSON HUMPHREY/AMERICAN EXPRESS, INC., *et al.*,

*Defendants.*

CIVIL ACTION No. C 85-172 A

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TOMMY E. PARKER, as custodian for KIMBERLY M. PARKER, and JAMES L. SMITH, on behalf of themselves and others similarly situated,

*Plaintiffs,*

vs.

PAINE WEBBER GROUP, INC.,

*Defendant.*

CIVIL ACTION No. C 85-1586 A

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SUZANNE KIRKPATRICK, DOROTHY D. CASLER, and CHARLES H. LINDSEY,

*Plaintiffs,*

vs.

J.C. BRADFORD & CO.,

*Defendants.*

CIVIL ACTION No. C 85-1891 A

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July 8, 1986

## OPINION OF VINING, DISTRICT JUDGE

## ORDER

In these federal securities actions, three motions are now before the court. The facts of these cases are set forth in this court's recent order, filed on March 28, 1986 ("the previous order"). The first motion is the plaintiffs' motion to reconsider the previous order, which denied their motion for class certification under Rule 23, Federal Rules of Civil Procedure. Second, the plaintiffs have asked this court to amend the previous order to certify it for interlocutory appeal, pursuant to Rule 5 of the Federal Rules of Appellate Procedure and 28 U.S.C. § 1292(b). Last, the plaintiffs have moved for an order staying the previous order until the date when the Eleventh Circuit Court of Appeals rules on the plaintiffs' interlocutory appeal. The court addresses each of these motions in turn.

### I. MOTION FOR RECONSIDERATION

The court's denial of class certification in each of these cases was based upon an extensive review of the record presented to the court through pleadings, discovery, and oral hearings. Five areas of concern required that the court deny class certification to the named plaintiffs. These areas of concern and the reasoning behind the court's treatment of each area are set out in complete detail in the previous order. The first of these is that the plaintiff cannot adequately represent the class as a whole as required by Rule 23(a)(4), Federal Rules of Civil Procedure. The remaining four bases for denial of class certification address the requirements of Rule 23(b)(3), that common questions of law and fact do not predominate over individual issues. These individual issues involve the requirement of proof of reliance as an element in actions under section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated under that Act; the fact that arbitration agreements signed by potential class members provide for a better, more efficient method of adjudicating the claims by many of the potential class participants; and the fact that many potential class members are from various states throughout the country, thus requiring application of their individual state statutes of limitations as well as the need to apply the law of each state in which potential class members reside.

The plaintiffs disagree with the court's finding in each of these areas and have requested the court to reconsider the class certification based upon these findings as well as the court's failure to address Counts I and II, brought pursuant to sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*(2). Each of these areas addressed by the plaintiffs will be discussed seriatim below. However, the court at this juncture believes it necessary to inform the plaintiffs of its method of handling the class certification issue.

First, the plaintiffs request that the court consider each individual issue, count, or other separate determination as a single issue not tied to any other issue for purposes of class certification. Although some courts have opted to bifurcate class actions, this court finds that to do so in this case would be unduly burdensome and would not be the best method of handling the cases. Therefore, the court has looked at each requirement of Rule 23, then combined its findings on each element of Rule 23 to determine whether class certification is appropriate for each case as a whole. For this reason, the court did not address the counts brought under sections 11 and 12(2) of the Securities Act of 1933. After reviewing the requirements for class certification under section 10(b) and Rule 10b-5 and the state law claims, the court determined that the plaintiffs had not met their burden of proving the elements necessary to meet the class certification requirements for these claims and did not, nor does it now, believe the section 11 and section 12(2) claims needed to be addressed in determining whether the plaintiffs' actions as a whole warrant class certification.

As to the remainder of the issues addressed by the plaintiffs in their motions to reconsider, the court believes that some clarification is necessary. After carefully considering each of the plaintiffs' contentions, the court finds them all without merit.

A. Rule 23(a)(4): Adequacy of Representation

In the previous order, the court held that the plaintiffs failed to satisfy the second requirement of Rule 23(a)(4) because they failed to convince the court that they would vigorously prosecute these class actions. Order at p. 22. First, the plaintiffs did not

attend the hearing. In the motion for reconsideration the plaintiffs contend that they did not appear at the hearing because the court quashed subpoenas seeking to compel their attendance. While the plaintiffs are correct that they were not *required* to attend the hearing, the court views their unwillingness to do so as *one indication* of a lack of interest in these lawsuits. Contrary to the plaintiffs' contentions, their failure to appear at the hearing was not *determinative*. As the court stated in its previous order, the "totality of the circumstances" surrounding this litigation led the court to its decision. *Id.*; *see id.* at 23-26 (setting out the other reasons that the plaintiffs are inadequate representatives).

The plaintiffs also contend that the court placed undue emphasis on their lack of familiarity with the complaint and the case as a whole. This court has stated that "the knowledge and involvement of plaintiff with the suit . . . [are] some of the factors relevant to a determination of a plaintiff's adequacy as a class representative." *Schatzman v. Talley*, 91 F.R.D. 270, 273 (N.D. Ga. 1981). Again, under the totality of the circumstances, the plaintiffs' lack of familiarity with these cases is another indication of their uncertain commitment to these lawsuits. The plaintiffs cite *Surowitz v. Hilton Hotels Corp., 383 U.S. 363, 86 S. Ct. 845 (1966), for the proposition that their lack of familiarity is not a critical issue. Surowitz* is inapposite because it does not address the degree of interest that a plaintiff must display to satisfy Rule 23(a)(4). *Surowitz* dealt with the question of whether a derivative plaintiff must personally investigate the facts underlying the complaint.

In the reply brief in *Parker*, the plaintiffs criticize the defendant for citing deposition testimony indicating that the defendant's broker, as opposed to the defendant, did not conceal the truth about Petro-Lewis. According to the plaintiffs, this lawsuit is against Paine Webber, not its brokers. Plaintiff Parker, however, does not have any reason to believe that either the defendant or its broker defrauded him:

> Q. Do you think that Lee Smith [Parker's broker] intended to deceive you?

A. No.

Q. Do you know of anybody at Paine Webber who intended to deceive you?

A. No, sir, I don't.

Q. Do you have any basis for believing that anybody at Paine Webber intended to deceive you?

A. No, sir, I don't.

Q. Do you believe that Lee Smith was part of a fraud or conspiracy to deceive you?

A. No, sir.

Q. Do you know of anybody at Paine Webber who was part of a fraud or conspiracy to deceive you?

A. No, sir.

Deposition of Tommy E. Parker, pp. 81-82.

Finally, the plaintiffs assert that courts have tolerated wide variances in the named plaintiffs' understanding of and involvement in class action lawsuits. They quote from *Ross v. BankSouth, N.A.*, [1985-86 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92, 526 (N.D. Ala. 1986), which takes a particularly lenient view of the threshold necessary to meet Rule 23(a)(4). Some courts, however, have been much more demanding of class representatives. For example, in *Greenspan v. Brassler*, 78 F.R.D. 130, 133-34 (S.D.N.Y. 1978), the court found that putative class representatives failed to satisfy Rule 23(a)(4) for some of the same reasons mentioned in this court's previous order:

> Although plaintiffs appear willing and able to bear the costs of this litigation, they have demonstrated an alarming unfamiliarity with the suit. They did not meet with their attorney until the basic groundwork

> of the action had been laid. Neither could identify any of the defendants other than NJB. Neither was aware of certain elements of the complaint. Indeed, plaintiffs appear to place undue emphasis on their counsel's ability to conduct the litigation. Plaintiffs' limited personal knowledge of the facts underlying this suit, as well as their apparently superfluous role in this litigation to date, indicate their inadequacy as class representatives. (citations to deposition testimony and cases omitted).

The court also finds that the analysis in *In re Goldchip Funding Co.*, 61 F.R.D. 592, 594 (M.D. Pa. 1974), which is quoted with approval in *Greenspan*, applies in this case:

> The class is entitled to more than blind reliance upon even competent counsel by uninterested and inexperienced representatives. A proper representative can offer more to the prosecution of a class action than mere fulfillment of the procedural requirements of Rule 23. He can, for example, offer his personal knowledge of the factual circumstances, and aid in rendering decisions on practical and non-legal problems which arise during the course of litigation. An attorney who prosecutes a class action with unfettered discretion becomes, in fact, the representative of the class. This is an unacceptable situation because of the possible conflicts of interest involved. (citation omitted).

Neither the Supreme Court nor the Eleventh Circuit has established specific guidelines for district courts to follow in making factual findings under Rule 23(a)(4). Determinations relating to the adequacy of a class representative are factual in nature--their resolution "depends on all the facts and circumstances of a particular case and is entrusted to the discretion of the trial court." *Dudo v. Schaffer*, 93 F.R.D. 524, 531 (E.D. Pa. 1982) (citations omitted); *see Freeman v. Motor Convoy, Inc.*, 700 F.2d 1339, 1347 (11th Cir. 1983). The plaintiffs have failed to point out any new facts or theories that would lead this court to change its holding.

B. Reliance and Fraud on the Market

The issue of reliance is central to a section 10(b) and Rule 10b-5 claim. The plaintiffs allege that the court's consideration of the issue of reliance at this point in the litigation process is an improper intrusion into the merits of the case. Although the court acknowledges that a consideration of the case on its merits is not always appropriate in determining class certification, it is generally accepted law in this circuit that the court may inquire into the merits of the case provided the granting or denial of class certification is not based upon whether the court believes the plaintiff may or may not prevail in its suit. *Huff v. N.D. Cass Co. of Alabama*, 485 F.2d 710 (5th Cir. 1973). Indeed, the Supreme Court has acknowledged the need for investigation into the merits of the case because "actual, not presumed, conformance with Rule 23(a) remains, however, indispensable," *General Telephone Co. of Southwest v. Falcon*, 457 U.S. 147, 160, 102 S. Ct. 2364, 2372, 72 L.Ed.2d 740 (1982),[1] in that "the class determination generally involves considerations that are 'enmeshed in the factual and legal issues comprising the plaintiffs cause of action,' " *Coopers & Lybrand v. Livsey*, 437 U.S. 463, 469, 98 S. Ct. 2454, 2458, 57 L.Ed.2d 351 (1978) quoting *Mercantile National Bank v. Langdeau*, 371 U.S. 555, 558, 83 S. Ct. 520, 522, 9 L.Ed.2d 523 (1963)).

The plaintiffs allege that the presumption of reliance in *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 92 S. Ct. 1456, 31 L.Ed.2d 741 (1972), should be applied to the cases at bar. This

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[1] The court notes that the plaintiffs are likely to assert that the reliance issue falls within Rule 23(b)(3), as discussed by this court, as opposed to Rule 23(a) in *Falcon* and that conformance with Rule 23(b) is not indispensable. However, one of the three sections of Rule 23(b) must be met for class certification purposes. Additionally, many courts have treated the issue of reliance as a typicality or commonality requirement, *e.g.*, *Nelson v. U.S. Steel Corp.*, 709 F.2d 675 (11th Cir. 1983), which treatment would necessarily thwart class action status as plaintiffs would fail to meet the indispensable requirements of Rule 23(a), reliance being an issue to be handled on an individual basis. This court, however, feels that some elements of typicality and commonality are present in each of the class representatives and has chosen to treat the issue of reliance under Rule 23(b).

court has thoroughly dealt with this presumption of reliance in its previous order and will not delve into the matter further. In an attempt to sway this court away from its prior decision denying to the plaintiffs the presumption of reliance based on the fraud on the market theory, the plaintiffs have brought to the court's attention several cases permitting this use of the fraud on the market theory. *See Ross v. BankSouth, N.A.*, Fed. Sec. L. Rep. [1985-86 Transfer Binder] ¶ 92,526 (N.D. Ala. 1986); *Klein v. A.G. Becker Paribas, Inc.*, 83 Civ. 6456 (GLG) (S.D.N.Y. March 19, 1986); *Dekro v. Stern Bros. & Co.*, 540 F. Supp. 406 (W.D. Mo. 1982); *Arthur Young & Co. v. United States District Court*, 549 F.2d 686 (9th Cir. 1977).

The *Klein* case sets forth the elements of a fraud on the market case. The elements necessary to establish a rebuttable presumption of reliance, as set out in *Klein*, are "that (1) an affirmative representation affected the price of a security traded on the open market, (2) the plaintiff relied to his detriment on the integrity of the market price, and (3) the price of the security 'reacted adversely' when the truth was revealed concerning the issuer of the security."

With the exception of *Arthur Young*, the cases cited by the plaintiffs allowing the fraud on the market theory to stand met the first element in *Klein* in that they involved sales of stocks or bonds on the *open market*. *Arthur Young* involved securities not traded on the open market. In fact, the securities were interests in five oil joint ventures similar to the interests sold in the instant cases. In *Arthur Young*, the parties were before the court on a motion by the defendants for a writ of mandamus requiring the district court to set aside its order and strike the class allegations from the complaint. The district court in *Arthur Young* had bifurcated the case allowing some issues to be certified for class action and other issues to be held for individual adjudication. One of the issues to be tried individually was that of reliance or causation. *Arthur Young*, 549 F.2d at 690. Additionally, the misrepresentations and omissions in *Arthur Young* did not involve *oral* misrepresentations. In fact, all claims based upon oral misrepresentations were withdrawn by the plaintiffs from the suit. *Arthur Young*, 549 F.2d at 689, n.5. Also, the court in

*Arthur Young* considered that case to be one involving only omissions, where reliance can be inferred under the *Ute* decision, rather than an *oral* misrepresentations and omissions case as are the cases at bar. *Arthur Young*, 549 F.2d at 694. The fact that reliance was held to be an individual issue, the fact that oral misrepresentations claims were withdrawn by the plaintiffs because of difficulties inherent in such claims in determining class action status, and the fact that the case was an omissions case are supportive of this court's position denying the class action in the instant cases and cannot be used to support the plaintiffs in their search for a theory on which to base class action status.

The remaining cases cited by the plaintiffs in support of the fraud on the market theory, *viz.*, *Dekro*, *Klein*, and *Ross*, involved securities sold on the open market, differentiating them from the cases at bar, where the securities were not sold on the open market. In *Ross*, the only case cited by the plaintiffs within the jurisdiction of the Eleventh Circuit, the court went to great lengths to outline instances where the fraud on the market presumption of reliance cannot be allowed. That court then, without sufficient factual analysis to support its decision, found the fraud on the market theory viable for purposes of determining reliance. It can only be assumed by this court that Judge Propst first determined the requirement that the securities be traded on the open market had been met before allowing the presumption of reliance under the fraud on the market theory.

*Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981), *cert. denied*, 459 U.S. 1102 (1983), obviates the need for trading on the open market if the security would not have been marketed at all but for the fraud. The plaintiffs alleged in their complaints that "but for the false and misleading statements contained in the registration statements and prospectuses and material information omitted therefrom, the Petro-Lewis partnership programs could not have been marketed and sold to plaintiffs and members of the class."[3] The plaintiffs assert that these allegations must be accepted as

[3] Robinson-Humphrey Amended Complaint, ¶ 55; J.C. Bradford Amended Complaint, ¶ 52; Paine Webber Second Amended Complaint, ¶ 50.

true for purposes of ruling on the class status motion but cite no support for this assertion. The court, however, is not required to look at and accept as true allegations of the complaint for purposes of Rule 23 class certification. *Huff v. N.D. Cass Co. of Alabama*, 485 F.2d 710, 713 (5th Cir. 1973). The plaintiffs' only support for the allegation, that but for the fraud and misleading statements the securities would not have been sold, lies in their reliance upon the suit filed by the Securities and Exchange Commission against Petro-Lewis, *see In re Petro-Lewis Securities Litigation*, [1984-85 Transfer Binder] ¶ 91,899 (D. Colo. 1984), and the assumption that the SEC never would have approved the offerings had the misrepresentations been discovered prior to approval.

First, it should be noted that the SEC does not approve nor disapprove securities for sale; it merely reviews the prospectus for compliance with SEC regulations. The issue then is not whether the SEC would have approved the offerings but whether the securities could have been sold but for the fraud. The reliance upon *In re Petro-Lewis* is misplaced as that case was settled out of court with the opinion of the court being that "in my view, after reviewing the entire matter, there are serious questions of law and fact which place the outcome of this action, if tried rather than settled, in substantial doubt." *In re Petro-Lewis*, ¶ 91,899 at p. 90,470. The support for the allegations that the securities would not have been sold but for the misrepresentations is not present, insofar as this court can determine, in the pleadings and evidence admitted by plaintiffs to the extent necessary to satisfy this court that the allegation has some basis and is not just a shot in the dark attempt to bring the case within the purview of a fraud on the market theory.

In addition to the element requiring sales on the *open market*, a fraud on the market claim under *Klein* requires that a plaintiff *rely* upon the integrity of the market in purchasing the securities. The court is aware of no evidence presented by the plaintiffs supporting this element. Indeed, the only information relied upon by each of the plaintiffs was information supplied

to them orally by their brokers.[3]

In light of the foregoing the court finds that the elements necessary to support a fraud on the market theory which would allow for a rebuttable presumption of reliance in a section 10(b) and Rule 10b-5 action are not present. The court has determined that reliance is paramount to the cases at bar. Due to the nature of these cases as oral misrepresentations cases the reliance must be proven on an individual basis. This requirement is, as stated in the court's previous order, one more obstruction to the granting of class status to these actions.

C. Arbitration

A third issue discussed by the court in its previous order is that of possible arbitration of claims against the defendants. In each of the three cases at bar the defendants have asserted that a number of potential class members have signed arbitration agreements with the defendants for handling of possible claims against them. Some of the defendants have presented no concrete evidence of arbitration agreements with the named plaintiffs. However, because of the general practice of brokerage firms to procure such agreements, the court is satisfied for purposes of class certification that each of the defendants is able to substantiate arbitration claims with some potential class members which could greatly disrupt these proceedings should class certification be granted.

The plaintiffs have referred the court to two recently decided cases concerning arbitration which the court feels compelled to address and distinguish. First, plaintiffs submit that this court should follow the decision in *McMahon v. Shearson/American*

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[3] The plaintiffs in *Paine Webber* have asserted in separate pleadings that they did not rely upon oral misrepresentations of the brokers but in fact relied upon prospectuses presented to them. However, the evidence as presented by the plaintiff and defendants on the issue of reliance and oral versus written misrepresentations is a defense which could be raised against these plaintiffs. Such a defense would be atypical of defenses which could be raised against other plaintiffs in *Paine Webber* and therefore would not allow for the presumption of reliance in *Paine Webber*.

*Express, Inc.*, 788 F.2d 94 (2d Cir. 1986), where Shearson sought to compel arbitration of Rule 10b-5 claims pursuant to arbitration agreements signed by the plaintiffs in that case. In *McMahon*, the Second Circuit, because of the failure of the Supreme Court in *Dean Witter Reynolds, Inc. v. Byrd*, ____ U.S. ____, 105 S. Ct. 1238 (1985) to rule on the arbitrability of 10(b) and 10b-5 claims, ruled that that circuit would not depart from its previous decisions that these claims are not arbitrable. While this court acknowledges the position of the Second Circuit in following the precedents in its circuit, it is not bound by that decision. This court holds that arbitration agreements signed by the plaintiffs and potential class members in the cases at bar are enforceable. *See Schultz v. Robinson-Humphrey/American Express, Inc.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 92,515 (M.D. Ga. 1986); *Chandler v. Drexel Burnham Lambert, Inc.*, No. C85-1585A (N.D. Ga. Oct. 28, 1985); *Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, Civ. No. C83-685A (N.D. Ga. May 16, 1985). This holding is based upon the national policy adhered to in *Byrd* of favoring arbitration agreements. *See also Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, ____ U.S. ____, 105 S. Ct. 3346 (1985). That these arbitration agreements may be readily enforceable leads this court to the determination that yet another individual issue predominates over common issues of law and fact. Additionally, these agreements provide what this court perceives to be a better method of adjudicating a large number of claims by potential plaintiffs against the defendants.

In a second attempt to bar the potential use of arbitration clauses by the defendants the plaintiffs draw the court's attention to *Smokey Greenhaw Cotton Co., Inc. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 785 F.2d 1274 (5th Cir. 1986). The plaintiffs cite this case to support the proposition that *Byrd* cannot be applied retroactively. The plaintiffs, however, fail to acknowledge the bold distinction between *Smokey Greenhaw* and the cases at bar. In *Smokey Greenhaw*, the questions to be submitted to arbitration had already been decided by a jury prior to *Byrd*. To apply *Byrd* in that instance would have required arbitration of issues already decided by a competent court of law. The court in fact states,

> Without so deciding, we might be more inclined to direct the parties to the arbitration room had this case been awaiting trial when the *Dean Witter Reynolds* opinion was handed down. However, equity demands that, where the trial has been completed, the proposed judgment rendered, and only the relative ministerial task of approving the form of the judgment remains, Greenhaw should not be denied his victory and forced once again to do battle in a different forum.

*Smokey Greenhaw*, 785 F.2d at 1279-80. Had the cases at bar been tried on their merits prior to the decision in *Byrd*, this court might well hold that the *Byrd* analysis was not retroactive. However, these cases have not yet even passed the preliminary procedural stages. For these reasons, the court adheres to its position as enunciated in its previous order with respect to the arbitrability issue of these class certifications.

D. Rule 10b-5: Statute of Limitations

In its previous order, this court held that because the statute of limitations is taken from state law, the claims are inappropriate for treatment as class actions. Order at pp. 42-43; *see Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979). In arguing that this court erred, the plaintiffs contend that the general rule in securities class actions involving a national class is that the court should apply a single statute of limitations for Rule 10b-5 claims. *See, e.g., State Teachers Retirement Board v. Fluor Corp.*, 80 F.R.D. 142, 144-45 (S.D.N.Y. 1978); *In re National Student Marketing Litigation* [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 97,926 (D.D.C. 1981). The plaintiffs, however, cite no circuit court authority for this proposition,* and they do not attempt to distinguish, or even discuss, *Elster*. Because the court continues to believe that the analysis in *Elster* is correct, this court adheres

* In fact, *In re National Marketing* relies on the reasoning in *State Teachers*. No other federal court has ever followed *State Teachers*.

to its prior holding. The plaintiffs have failed to cite any appellate or Supreme Court authority that dictates another result.

E. State and Common Law Claims

The plaintiffs next argue that this court failed to engage in the analysis mandated by *Phillips Petroleum Co. v. Shutts*, ____ U.S. ____, 105 S. Ct. 2965 (1985), and misapplied the holding in that case.[5] In part III of the *Shutts* opinion, the Supreme Court began by establishing that Kansas contract and equity law differed from Texas and Oklahoma contract and equity law. *See id.* at ____, 105 S. Ct. at 2977-78. Similarly, this court outlined the differences in the elements of a fraud claim in numerous jurisdictions in this country. *See* Order at pp. 49-51. Like the Supreme Court in *Shutts*, this court concluded that, based on the differences in the laws of the various states, it would be unconstitutional for the court to apply Georgia law to transactions in which investors had no contact with Georgia, nor any reasonable expectation that Georgia law would apply to their purchases.[6] *Shutts* holds that a court "may not take a transaction with little or no

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[5] The plaintiffs do not address *Simon v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.2d 880, 883 (5th Cir. 1973), in which the court held:

> [T]he geographic dispersion of the alleged representations would bring into issue various state common law standards. With no single law governing the entire class, common issues of law cannot be shown to warrant Rule 23 treatment.

That decision is binding on this court. *See Bonner v. City of Prichard*, 661 F.2d 1206, 1209 (11th Cir. 1981) (*en banc*) (adopting the law of the Fifth Circuit prior to October 1, 1981, as binding precedent). In addition, the plaintiffs once again failed to distinguish or even address *Elster v. Alexander*, 76 F.R.D. 440, 442 (N.D. Ga. 1977), *appeal dismissed*, 608 F.2d 196 (5th Cir. 1979). *See* Order at pp. 48-49 (citing decisions that follow the reasoning in *Simon* and *Elster*).

[6] In *Sanders* the defendants' attorney indicates that his examination of client mailing lists taken from the defendants' business files shows that the defendants sold Petro-Lewis limited partnership interests to clients maintaining addresses in 32 states, the District of Columbia, and West Germany. Supplemental Affidavit of Peter J. Anderson, ¶ 3.

relationship to the forum and apply the law of the forum in order to satisfy the procedural requirement that there be a 'common question of law.' " *Shutts*, ____ U.S. at ____, 105 S. Ct. at 2980.

The Supreme Court in *Shutts* also quoted from *Allstate Insurance Co. v. Hague*, 449 U.S. 302, 312-13, 101 S. Ct. 633, 640 (1981), in which it had stated, "For a State's substantive law to be selected in a constitutionally permissible manner, that State must have a significant contact or significant aggregation of contacts, creating state interests, such that choice of its law is neither arbitrary nor fundamentally unfair." In the instant case, the named plaintiffs are residents in this district and the defendants do business here. Based on these facts alone, the court fails to see how Georgia has "a significant contact or significant aggregation of contacts, creating state interests" such that Georgia law should apply to investors from other parts of the country. As the Supreme Court stated, "Given [Georgia's] lack of 'interest' in claims unrelated to that State, and the substantive conflict with jurisdictions such as Texas, we conclude that application of [Georgia] law to every claim in this case is sufficiently arbitrary and unfair as to exceed constitutional limits." *Shutts*, ____ U.S. at ____, 105 S. Ct. at 2980 (footnote omitted).

The plaintiffs contend that this court should adopt the reasoning in *In re Pizza Time Theatre Securities Litigation*, No. C-84-20048 (A), Order Certifying Plaintiff Class (N.D. Cal. March 18, 1986), in which a California district court interpreted *Shutts* to mean that plaintiffs "must demonstrate only that California has a sufficient aggregation of contacts to their *claims* to insure that the application of California law would not be arbitrary or unfair." Slip op. at 4 (emphasis in original). The *Pizza Time* court explained California's interest in applying its own law to the pendent claims in the class action:

> In the instant action, California has a considerably greater aggregate of contacts with plaintiffs' claims than did Kansas in the *Shutts* case. Here, the defendant corporation was incorporated and headquartered in California, all the non-underwriter defendants were California residents, the alleged misrepresentations emanated from California, and many of the plaintiffs

> were California residents. The non-resident underwriter defendants received millions of dollars in fees from the California corporation, and the plaintiffs allege that the underwriter defendants conspired with the California defendants to defraud the plaintiffs. Not only are the contacts evident, but California has a strong interest in the allegedly fraudulent conduct of its corporations and residents, and in protecting its residents and others from such fraud. The application of California law to the pendent claims in this case would not be arbitrary. *Id.* at Slip Op. at 4-5.

In this case, however, Georgia has nowhere near the number of contacts that California had with the plaintiffs' claims in *Pizza Time*: Robinson-Humphrey is the only defendant that is either incorporated or headquartered in Georgia; the alleged misrepresentations emanated from all over the country because the putative class members purchased partnership interests from brokerage houses all over the country; and many of the putative class members are not Georgia residents. While California may have had a sufficient aggregation of contacts to the plaintiffs' claims in *Pizza Time*, that is clearly not the case here. The facts in this action more closely resemble the facts in *Shutts* than *Pizza Time*.

A second reason that this court will not follow *Pizza Time* is that *Shutts* does not overrule the reasoning in *Simon*, 482 F.2d at 883, or *Elster*, 76 F.R.D. at 442. This court will follow these decisions.

Finally, the *Shutts* court held that an important element in deciding whether to certify a class is the expectation of the parties. As in *Shutts*, there is no indication that when the investors purchased the limited partnership interests outside of Georgia they had any idea that Georgia law would control. *Shutts*, ____ U.S. at ____, 105 S. Ct. at 2980.[7]

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[7] Another reason that *Pizza Time* is inapposite is that the California court concluded that "California's aggregate contacts with, and interest in, the events

*(footnote continued)*

## II. INTERLOCUTORY APPEAL

The plaintiffs have asked this court to amend its earlier order to certify it for interlocutory appeal, pursuant to Rule 5, Federal Rules of Appellate Procedure. Rule 5 provides that an order may be amended at any time to include the statement prescribed by 28 U.S.C. § 1292(b). This statute states in part:

> When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals may thereupon, in its discretion, permit an appeal to be taken from such order. . . .

First, the court finds that several controlling questions of law exist about which substantial grounds exist for differences of opinion. While a section 1292(b) review is inappropriate for challenges to a judge's discretionary rulings, *Garner v. Wolfinbarger*, 433 F.2d 117, 120 (5th Cir. 1970), the court finds that the legal issues that it has discussed under Rule 23(b), *see* Order at pp. 27-51, are by no means settled.

As to the issues of reliance and fraud on the market, the Eleventh Circuit has accepted a presumption of reliance based upon a fraud on the market theory, *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984); *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102, 103 S. Ct. 722 (1983). However, the fraud on the market presumption of reliance has presented some ambiguities as to its application to securities not sold on the open market; furthermore there is no clear

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alleged in the complaint were self-evident at the time and sufficient to give notice to the parties that California law might apply in any subsequent litigation." *Pizza Time*, Slip op. at 5.

definition of what the "open market" actually is. *See Arthur Young & Co. v. United States District Court*, 549 F.2d 686 (9th Cir. 1977); *Ross v. BankSouth, N.A.*, Fed. Sec. L. Rep. [1985-86 Transfer Binder] ¶ 92,526 (N.D. Ala. 1986). An interlocutory appeal of this court's ruling on this issue is thus warranted by the facts of the case at bar.

In addition, while this court has held that section 10(b) and Rule 10b-5 claims under the Securities Exchange Act of 1934 are arbitrable, *see Raiford v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, C83-685A (N.D. Ga. May 16, 1985); *Chandler v. Drexel Burnham Lambert, Inc.*, C85-1585A (N.D. Ga. Oct. 28, 1985), the Eleventh Circuit, sitting *en banc*, just heard oral argument on this issue. *Wolfe v. E.F. Hutton*, No. 85-3352 (11th Cir.) (*en banc*). District court decisions in this circuit are conflicting. *Compare Ross v. Mathis*, 624 F. Supp. 110 (N.D. Ga. 1986) (holding Rule 10b-5 claims arbitrable) *with GMO V.A. Del Castillo v. Paine Webber, Inc.*, C85-2410A (N.D. Ga. Dec. 12, 1985) (holding Rule 10b-5 claims not arbitrable).

Another reason why this case should be certified for interlocutory appeal is that some courts have held that securities class actions involving a national class require a court to apply a single statute of limitations for Rule 10b-5 claims of the entire class. *See, e.g., State Teachers Retirement Board v. Fluor Corp.*, 80 F.R.D. 142, 144-45 (S.D.N.Y. 1978); *In re National Student Marketing Litigation*, [1981 Transfer Binder], Fed. Sec. L. Rep. (CCH) ¶ 97, 926 (D.D.C. 1981). Although this court disagrees with the holding in those cases, the court does recognize that this is a controlling question of law as to which there is substantial ground for difference of opinion.

Finally, the plaintiffs contend that this court has misinterpreted the holding in *Phillips Petroleum Co. v. Shutts*, ____ U.S. ____, 105 S. Ct. 2965 (1985), and misapplied it to the facts at bar. Again, the court believes its decision is correct but also recognizes that there is substantial ground for difference of opinion.

The court finds that an immediate appeal from its previous order and this order will materially advance the ultimate

termination of this litigation. Resolving the class certification on interlocutory appeal will prevent any duplicative effort by both sides of this litigation if investors individually proceed to bring the same or similar claims against the defendants. An appeal will provide an efficient mechanism for the prompt resolution of many of the issues in this case.

For these reasons, the plaintiffs' motion to amend this court's previous order to certify it for interlocutory appeal is GRANTED, and the court hereby certifies this order for interlocutory appeal also.

## III. MOTION TO STAY

The final motion before this court is the plaintiffs' motion for an order staying this court's previous order until the date when the Eleventh Circuit rules on the plaintiffs' interlocutory appeal. The plaintiffs seek to toll the statute of limitations concerning all claims of all putative class members. This motion is made pursuant to 28 U.S.C. § 1292(b), which provides in part: ". . . application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order."

Under Local Rule 300-4 and this court's previous order, the plaintiffs' attorneys were prevented from communicating with putative class members who contacted them concerning possible lawsuits against the defendants. These potential class members have been deprived of the opportunity to assert their claims during the pendency of the motions for class certification. The combined effect of the Local Rule and this court's order may be to effectively prevent these individuals from pursuing their legal claims. If the court does not stay its previous order, many individuals may unknowingly lose their right to bring certain causes of action. A stay may provide additional protection for putative class members until the Eleventh Circuit determines whether the class action device is available. (This court does not decide whether the stay will, in fact, toll the statute of limitations.)

In addition, many putative members of the class have not been in contact with the plaintiffs' attorneys and may be unaware of

the potential prejudice to their rights that may result from this court's previous order. Many of these individuals may be unaware of the impending limitations deadline. This court recognizes the potential prejudice to putative class members from its previous order and does not want to deny these individuals due process of law or a day in court. Accordingly, the motion to stay is GRANTED.

## IV. SUMMARY

The plaintiffs' motion to reconsider this court's order filed on March 28, 1986, denying the plaintiffs' motion for class certification under Rule 23, Federal Rules of Civil Procedure is DENIED. The plaintiffs' motion to amend this court's previous order to certify this case for interlocutory appeal pursuant to Rule 5, Federal Rules of Appellate Procedure and 28 U.S.C. § 1292(b) is GRANTED. The plaintiffs' motion for an order staying its previous order is GRANTED, and proceedings are hereby STAYED until the date on which the Eleventh Circuit denies the plaintiffs' request for an interlocutory appeal or, if granted, the date on which the Eleventh Circuit issues its mandate following the appeal.

SO ORDERED.

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

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No. 88-2086

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TOMMY E. PARKER, as custodian for
KIMBERLY M. PARKER, and JAMES L. SMITH,
on behalf of themselves and all others
similarly situated,

Petitioners.

versus

PAINE WEBBER GROUP, INC.,

Respondent.

- - - - - - - -

Application for Permission to Appeal from the United States District Court for the Northern District of Georgia

- - - - - - - -

Before HILL, KRAVITCH and FAY, Circuit Judges.

BY THE COURT:

The petition for permission to appeal pursuant to 28 U.S.C. § 1292(b) is granted.

U.S. COURT OF APPEALS
ELEVENTH CIRCUIT
FILED AUG 21, 1986
MIGUEL J. CORTEZ, CLERK

# STATUTORY AND REGULATORY PROVISIONS INVOLVED

**Section 10(b) of the Securities Exchange Act of 1934, Title 15, United States Code**

**§ 78j. Manipulative and deceptive devices**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

**Securities and Exchange Commission Rule 10b-5, Title 17, Code of Federal Regulations**

**§ 240.10b-5 Employment of manipulative and deceptive devices.**

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

**Section 11 of the Securities Act of 1933, Title 15, United States Code**

**§ 77k. Civil liabilities on account of false registration statement**

**Persons possessing cause of action; persons liable**

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

If such person acquired the security after the issuer has made generally available to its security holders an earning statement covering a period of at least twelve months beginning after the effective date of the registration statement, then the right of

recovery under this subsection shall be conditioned on proof that such person acquired the security relying upon such untrue statement in the registration statement or relying upon the registration statement and not knowing of such omission, but such reliance may be established without proof of the reading of the registration statement by such person.

**Persons exempt from liability upon proof of issues**

(b) Notwithstanding the provisions of subsection (a) of this section no person, other than the issuer, shall be liable as provided therein who shall sustain the burden of proof—

(1) that before the effective date of the part of the registration statement with respect to which his liability is asserted (A) he had resigned from or had taken such steps as are permitted by law to resign from, or ceased or refused to act in, every office, capacity, or relationship in which he was described in the registration statement as acting or agreeing to act, and (B) he had advised the Commission and the issuer in writing that he had taken such action and that he would not be responsible for such part of the registration statement; or

(2) that if such part of the registration statement became effective without his knowledge, upon becoming aware of such fact he forthwith acted and advised the Commission, in accordance with paragraph (1) of this subsection, and, in addition, gave reasonable public notice that such part of the registration statement had become effective without his knowledge; or

(3) that (A) as regards any part of the registration statement not purporting to be made on the authority of an expert, and not purporting to be a copy of or extract from a report or valuation of an expert, and not purporting to be made on the authority of a public official document or statement, he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement

became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading; and (B) as regards any part of the registration statement purporting to be made upon his authority as an expert or purporting to be a copy of or extract from a report or valuation of himself as an expert, (i) he had, after reasonable investigation, reasonable ground to believe and did believe, at the time such part of the registration statement became effective, that the statements therein were true and that there was no omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or (ii) such part of the registration statement did not fairly represent his statement as an expert or was not a fair copy of or extract from his report or valuation as an expert; and (C) as regards any part of the registration statement purporting to be made on the authority of an expert (other than himself) or purporting to be a copy of or extract from a report or valuation of an expert (other than himself), he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement of the expert or was not a fair copy of or extract from the report or valuation of the expert; and (D) as regards any part of the registration statement purporting to be a statement made by an official person or purporting to be a copy of or extract from a public official document, he had no reasonable ground to believe and did not believe, at the time such part of the registration statement became effective, that the statements therein were untrue, or that there was an omission to state a material fact required to be stated therein or necessary to make the statements therein not misleading, or that such part of the registration statement did not fairly represent the statement made by the official person or was not a fair copy of or extract from the public official document.

**Standard of reasonableness**

(c) In determining, for the purpose of paragraph (3) of subsection (b) of this section, what constitutes reasonable investigation and reasonable ground for belief, the standard of reasonableness shall be that required of a prudent man in the management of his own property.

**Effective date of registration statement with regard to underwriters**

(d) If any person becomes an underwriter with respect to the security after the part of the registration statement with respect to which his liability is asserted has become effective, then for the purposes of paragraph (3) of subsection (b) of this section such part of the registration statement shall be considered as having become effective with respect to such person as of the time when he became an underwriter.

**Measure of damages; undertaking for payment of costs**

(e) The suit authorized under subsection (a) of this section may be to recover such damages as shall represent the difference between the amount paid from the security (not exceeding the price at which the security was offered to the public) and (1) the value thereof as of the time such suit was brought, or (2) the price at which such security shall have been disposed of in the market before suit, or (3) the price at which such security shall have been disposed of after suit but before judgment if such damages shall be less than the damages representing the difference between the amount paid for the security (not exceeding the price at which the security was offered to the public) and the value thereof as of the time such suit was brought: *Provided*, That if the defendant proves that any portion or all of such damages represents other than the depreciation in value of such security resulting from such part of the registration statement, with respect to which his liability is asserted, not being true or omitting to state a material fact required to be stated therein or necessary to make the statements therein not misleading, such portion of or all such damages shall not be recoverable. In no event shall any underwriter (unless such underwriter shall have knowingly received

from the issuer for acting as an underwriter some benefit, directly or indirectly, in which all other underwriters similarly situated did not share in proportion to their respective interests in the underwriting) be liable in any suit or as a consequence of suits authorized under subsection (a) of this section for damages in excess of the total price at which the securities underwritten by him and distributed to the public were offered to the public. In any suit under this or any other section of this subchapter the court may, in its discretion, require an undertaking for the payment of the costs of such suit, including reasonable attorney's fees, and if judgment shall be rendered against a party litigant, upon the motion of the other party litigant, such costs may be assessed in favor of such party litigant (whether or not such undertaking has been required) if the court believes the suit or the defense to have been without merit, in an amount sufficient to reimburse him for the reasonable expenses incurred by him, in connection with such suit, such costs to be taxed in the manner usually provided for taxing of costs in the court in which the suit was heard.

**Joint and several liability**

(f) All or any one or more of the persons specified in subsection (a) of this section shall be jointly and severally liable, and every person who becomes liable to make any payment under this section may recover contribution as in cases of contract from any person who, if sued separately, would have been liable to make the same payment, unless the person who has become liable was, and the other was not, guilty of fraudulent misrepresentation.

**Offering price to public as maximum amount recoverable**

(g) In no case shall the amount recoverable under this section exceed the price at which the security was offered to the public.

**Section 12(2) of the Securities Act of 1933, Title 15, United States Code**

**§ 77*l*. Civil liabilities arising in connection with prospectuses and communications**

Any person who—

* * *

(2) offers or sells a security (whether or not exempted by the provisions of section 77c of this title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

**Rule 23 of the Federal Rules of Civil Procedure**

**Class Actions**

(a) **Prerequisites to a Class Action.** One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the

representative parties will fairly and adequately protect the interests of the class.

(b) **Class Actions Maintainable.** An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

(1) the prosecution of separate actions by or against individual members of the class would create a risk of

(A) inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate action; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) **Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.**

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b)(3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and (C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c)(2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) **Orders in Conduct of Actions.** In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation

of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

## Title 28, United States Code

### § 1292. Interlocutory decisions

(b) When a district judge, in making a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he shall so state in writing in such order. The Court of Appeals which would have jurisdiction of an appeal of such action may thereupon, in its discretion, permit an appeal to be taken from such order, if application is made to it within ten days after the entry of the order: *Provided, however,* That application for an appeal hereunder shall not stay proceedings in the district court unless the district judge or the Court of Appeals or a judge thereof shall so order.

Supreme Court, U.S.
FILED
JAN 6 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-932

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1987

J.C. BRADFORD & CO.,
*Petitioner,*

vs.

SUZANNE KIRKPATRICK, DOROTHY D. CASLER
and CHARLES H. LINDSEY,
on behalf of themselves
and all other similarly situated,
*Respondents.*

## ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

## RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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## COUNTERSTATEMENT OF THE QUESTIONS PRESENTED FOR REVIEW

1. Is it appropriate for this Court to exercise its certiorari jurisdiction to review a decision of the United States Court of Appeals for the Eleventh Circuit which neither granted nor denied a motion for class certification in an action arising under the federal securities laws but, rather, remanded the matter to the District Court for further proceedings consistent with its decision?

2. Did not the Court of Appeals for the Eleventh Circuit properly conclude that the District Court, in ruling on a motion for class certification, was not permitted to disregard the allegations of respondents' Complaint and recharacterize the case in a manner which respondents neither pleaded nor intend to prove?

3. Did not the Court of Appeals for the Eleventh Circuit properly conclude that respondents were entitled to a presumption of reliance under the "fraud on the market" theory adopted by an *en banc* panel of the predecessor to that Circuit in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983)?

## PARTIES TO THE PROCEEDING

The names of the parties to the proceeding are contained in the caption.

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| *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F.Supp. 1048 (N.D. Ga. 1986) | *passim* |
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No. 87-932

IN THE

# Supreme Court of the United States

OCTOBER TERM, 1987

J.C. BRADFORD & CO.,
*Petitioner,*

vs.

SUZANNE KIRKPATRICK, DOROTHY D. CASLER
and CHARLES H. LINDSEY,
on behalf of themselves
and all other similarly situated,
*Respondents.*

## ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE ELEVENTH CIRCUIT

## RESPONDENTS' BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondents Suzanne Kirkpatrick, Dorothy D. Casler and Charles H. Lindsey, on behalf of themselves and all other similarly situated ("respondents"), respectfully request that the Court deny the Petition for a Writ of Certiorari to the United States Court of Appeals for the Eleventh Circuit (the "Petition") submitted by J.C. Bradford & Co. ("petitioner") to review a judgment of the United States Court of Appeals for the Eleventh Circuit which reversed in part, affirmed in part and remanded an order of the United States District Court for the Northern District of Georgia denying respondents' motion for class certification.

## OPINIONS BELOW

The opinion of the United States Court of Appeals for the Eleventh Circuit (App. Exhibit A)[1] is reported as *Kirkpatrick v. J. C. Bradford & Co.*, 827 F.2d 718 (11th Cir. 1987). The order of the Court of Appeals denying petitioner's petition for rehearing and suggestion of rehearing *en banc* is not reported and is set forth in the Appendix as Exhibit B. The order staying the mandate of the Court of Appeals is not reported and is set forth in the Appendix as Exhibit C.

The opinion of the United States District Court for the Northern District of Georgia denying respondents' motion for class certification (App. Exhibit D) is reported as *Sanders v. Robinson Humphrey/American Express, Inc.*, 634 F.Supp. 1048 (N.D. Ga. 1986). The District Court's opinion denying respondents' motion for reconsideration, granting respondents' motion to certify the case for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982), and staying the District Court's order denying class certification (App. Exhibit E) is reported as *Sanders v. Robinson Humphrey/American Express, Inc.*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,880 (N.D. Ga. July 8, 1986).

The order of the Court of Appeals accepting the appeal pursuant to 28 U.S.C. § 1292(b) (1982) is not reported and is set forth in the Appendix as Exhibit F.

## JURISDICTION

The judgment of the Court of Appeals was entered on September 15, 1987. (App. Exhibit A). Rehearing and rehearing *en banc* were denied by order dated October 21, 1987. (App. Exhibit B). The mandate of the Court of Appeals was stayed on November 17, 1987. (Appendix Exhibit C). Petitioner purports to invoke this Court's jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

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[1] Citations herein to material printed in the Appendix appear as either "Appendix" or "(App. ___)." Such citations are to the Appendix to the Petition filed by petitioner on or about December 7, 1987.

## STATUTES AND RULES INVOLVED

The statutes and rules involved in the case are Sections 11 and 12(2) of the Securities Act of 1933, 15 U.S.C. §§ 77k, 77*l*(2) (1982); Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (1982); Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1987); Rule 23 of the Federal Rules of Civil Procedure; and 28 U.S.C. § 1292(b) (1982). (App. Exhibit G).

## COUNTERSTATEMENT OF THE CASE

### Background

The instant case represents but a small part of the litigation arising out of the debacle involving Petro-Lewis, and brokerage firms such as petitioner which assisted Petro-Lewis in its scheme.[2] Over a 14-year period, Petro-Lewis sold, through securities brokerage firms, in excess of three billion dollars ($3,000,000,000) in limited partnerships to approximately 180,000 people. Brokerage firms such as petitioner readily participated in perpetrating this massive fraudulent scheme for a very simple reason—greed. These firms earned huge commissions for selling these securities—commissions which greatly exceeded their normal commissions.

From 1970 through 1983, Petro-Lewis was the nation's largest seller of oil and natural gas "income funds". These income funds were sold as safe, secure, conservative investments. Petro-Lewis and petitioner lured new investors with enticements of stable annual returns of 12% or more earned by previous partnerships, and by the apparent liquidity provided by Petro-Lewis' pledge to repurchase any partnership interest tendered by investors.

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[2] This case arises out of the same facts and involves the same legal issues presented in companion cases before this Court, *Robinson-Humphrey/American Express, Inc. v. Glenn T. Sanders and Leslie D. Sanders*, Case No. 87-835, and *Paine Webber Group, Inc. v. Parker, et al.*, Case No. 87-836.

The method of operation was consistent during the entire period in question. Petro-Lewis formed a new partnership each month. Cash distributions to the limited partners, which were paid quarterly, began almost immediately after each partnership was formed and were to continue for 10 to 15 years or more until the wells were depleted. Funds to pay partnership distributions were supposed to come from profits realized from the sale of oil and gas produced by the partnership properties.

Crucial to the success of this marketing scheme was the apparent steady pattern of cash flow to the limited partners, commencing almost immediately after the formation of the partnerships. Petro-Lewis and petitioner touted this "regular, reasonably predictable pattern of distributions" in prospectuses for the partnerships and in other written material distributed to potential investors. *Sanders v. Robinson-Humphrey/American Express, Inc.*, 634 F.Supp. 1048, 1050 (N.D. Ga. 1986)(App. D-2).

Petitioner played an important role in the marketing of these programs, selling in excess of $50,000,000 of limited partnership interests to over 8,000 investors. Petitioner found these programs to be extremely lucrative since Petro-Lewis paid commissions at a rate which averaged 7%, far in excess of the normal commissions earned on the sale of stocks and bonds.

Petitioner's desire to sell Petro-Lewis units permeated its entire organization. The units were marketed and sold to retirees, pension and profit-sharing plans, and other investors who desired conservative investments. Petitioner and its brokers actively assisted Petro-Lewis in disseminating prospectuses and other documents which contained numerous omissions and misrepresentations. Petro-Lewis itself closely monitored the sales by petitioner's brokers, and gave prizes to those brokers who achieved certain sales levels. *Sanders*, 634 F.Supp. at 1055 (App. D-6 to 7).

However, unbeknownst to the investors and members of the class, the impression of financial strength and success created by Petro-Lewis and petitioner was wholly unfounded.

This impression was designed specifically to attract new investors, and to deter existing partners from exercising their redemption options. The truth was that, contrary to the impression conveyed to the public, by at least the beginning of 1981, Petro-Lewis and its partnerships were experiencing serious financial problems. Without continuing sales to new investors, Petro-Lewis would run out of money to fund its operations and pay cash distributions.

Petro-Lewis had paid premium prices for the partnership properties and had borrowed heavily from banks to help finance the acquisitions. The funds to repay those loans, like the cash distributions to the partners, were supposed to come from the profits generated by the sale of oil and gas produced by the partnership properties. However, the advent of the world oil glut and attendant reduction in oil and gas prices in the early 1980's—coupled with, among other things, increased operating costs, huge debt service requirements and competition from other petroleum investment programs—resulted in a reduction in cash flow from the partnership properties. These conditions put Petro-Lewis in a serious cash bind and jeopardized the partnership holdings.

In 1984, the Ponzi scheme collapsed. Petro-Lewis suspended its partnership syndication operations and sold almost one third of the oil and gas reserves held by the partnerships in order to achieve a one billion dollar ($1,000,000,000.00) reduction in bank debt. Petro-Lewis also cut distributions to limited partners, imposed a cap on redemptions of partnerships, and reduced the prices at which Petro-Lewis repurchased those interests to a fraction of previous levels. Investors learned for the first time that the reserves purchased with their capital contributions were worth only ⅓ to ½ of what the partnerships had paid for them. *Sanders,* 634 F.Supp. at 1054 (App. D-6).

Investors who retained their partnership interests held, until recently, units in a royalty trust, which was created as part of the complicated settlement of *In re: Petro-Lewis Securities Litigation,* [1984-85 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 91,899 (D.Colo. 1984), a class action against Petro-

Lewis, its officers and directors. The defendants in that case consented to class certification and a settlement less than six (6) months after the complaint was filed; however, the amount recovered, $23.5 million, was hardly sufficient to compensate the individuals who suffered such astronomical losses. Therefore, members of the class involved in the Colorado litigation expressly retained their rights to pursue their claims against the brokerage firms, including petitioner and other brokerage firms who had participated with Petro-Lewis in marketing the limited partnerships interests. Even taking into account the proceeds from the *Petro-Lewis* settlement, losses to the investors and members of the proposed class in this case have been enormous. *Sanders,* 634 F.Supp. at 1050, 1052 (App. D-4).

**Course Of Proceedings And Disposition In The Courts Below**

On March 6, 1985, respondents filed a Class Action Complaint (the "Complaint") against petitioner for violations of the federal securities laws and common law arising out of its participation in the scheme outlined above. The Complaint asserts claims against petitioner under Sections 11 and 12(2) of the Securities Act of 1933 (the "Securities Act"), 15 U.S.C. §§ 77k and 77*l*(2), Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. § 78j(b), Rule 10b-5 promulgated thereunder, 17 C.F.R. § 240.10b-5 (1987), and for common law fraud, fraudulent concealment, negligence and breach of fiduciary duty. The thrust of the Complaint is that petitioner violated these statutory and common law provisions: (1) by disseminating virtually identical prospectuses for the partnership programs during the class period which omitted materially adverse information concerning Petro-Lewis and its partnerships, and (2) by perpetrating a scheme and common course of conduct at the highest levels of petitioner's corporate management which had the purpose and effect of suppressing the truth about the precarious financial condition of Petro-Lewis and its partnership programs. *Kirkpatrick v. J. C. Bradford & Co.,* 827 F.2d 718, 721 (11th Cir. 1987) (App. A-5).

BEST

The Complaint contains more than thirty (30) pages of allegations that the prospectuses and other written documents disseminated by Petro-Lewis and petitioner were false and misleading. The Complaint alleges in excruciating detail the omissions and misrepresentations contained in the prospectuses. Significantly, all of the allegations set forth in respondents' Complaint were asserted by the Securities and Exchange Commission ("SEC") in a separate complaint filed against Petro-Lewis seven months after this litigation began.

Among these allegations are the following:

1. The prospectuses failed to disclose the risks inherent in purchasing Petro-Lewis limited partnership interests;

2. The prospectuses failed to disclose the excessive leveraging of the partnerships;

3. The prospectuses failed to disclose that Petro-Lewis engaged in a pattern of "propping up" cash distributions to the partnerships by using borrowed funds. In fact, respondents received documents during the discovery process which show that the cash distributions to the partnerships had been supported by up to forty percent (40%) through the use of borrowed funds, a material fact which respondents allege was not disclosed to class members;

4. The prospectuses failed to disclose that distributions were being inflated in order to ensure that sales continued;

5. The prospectuses failed to disclose that substantial tax benefits expected to be received by class members were likely to be disallowed;

6. The prospectuses failed to disclose that declines in the price of oil would and did make it impossible to adequately service the partnerships' debt;

7. The prospectuses failed to disclose that due to Petro-Lewis' policy of borrowing to make distributions, a substantial risk existed that, contrary to the statements in the prospectuses, no funds would be available to repurchase interests;

AVAILABLE COPY

8. The prospectuses failed to adequately disclose that Petro-Lewis utilized improper or highly questionable accounting practices and policies; and

9. The documents disseminated by Petro-Lewis and petitioner failed to disclose that extensive leveraging created the risk of forced liquidation of partnership assets.

The conspiracy and common course of conduct which respondents' Complaint alleges was perpetrated at the highest levels of petitioner's corporate management. Respondents do not complain of, nor have they ever asserted any claim based upon, any oral statements made to them or any other class member by any individual employed by petitioner. *Kirkpatrick*, 827 F.2d at 721, 724 (App. A-5, 10 to 11). *See also Sanders*, 634 F.Supp. at 1053-54 (App. D-6 to 9).

The hearing on respondents' motion for class certification took place on February 27, 1986 following briefing and discovery. In its papers opposing the motion, petitioner consistently mischaracterized respondents' case to the District Court, arguing that it was one based solely on "oral misrepresentations." This self-serving characterization was reached only by totally ignoring respondents' Complaint in this case, and through a gross distortion of the record which had been developed on the class issue.[3]

In an order dated March 27, 1986, the District Court denied respondents' motion for class certification. The District Court refused to give separate consideration to class treatment of respondents' Securities Act claims. With respect to respondents' Exchange Act claims, the District Court specifically found that the case "clearly" satisfied the "commonality" requirement of Rule 23(a)(2) of the Federal Rules of Civil Procedure. The District Court held that all members of the class shared numerous common legal and factual issues relating to the prospectuses and petitioner's persistent failure to disclose

[3] Respondents made detailed written submissions to the District Court on the class motion prior to the hearing. This included, in addition to extensive briefs, numerous items of documentary evidence and other factual material.

material facts concerning the risks inherent in the Petro-Lewis programs. *Sanders*, 634 F.Supp. at 1056 (App. D-13). Similarly, the District Court found that the "typicality" requirement of Rule 23(a)(3) was easily satisfied in the case in light of the allegations that petitioner had engaged in a common course of conduct which affected each member of the class in the same manner. *Sanders*, 634 F.Supp. at 1057 (App. D-15).

When it reached the "predominance" element of Rule 23(b)(3), however, the District Court took an entirely different view of the case. In a totally inexplicable reversal of position, the District Court disregarded its own findings on "commonality" and "typicality". The District Court inconsistently ruled that respondents' Section 10(b) and Rule 10b-5 claims were grounded solely upon "oral misrepresentations" between members of the class and their individual brokers—a formulation of the case which respondents had neither pleaded nor intended to prove. The District Court adopted that characterization despite the absence from the Complaint of any allegation that respondents' claims were grounded on any such oral statements. Having thus recast the case, the District Court ruled that class certification of the Section 10(b) and Rule 10b-5 claims would be appropriate only if respondents were able to demonstrate that petitioner had engaged in a uniform "presentation" or standardized "sales pitch" directed to each and every member of the class. Finding the "evidence" on this issue to be deficient, the District Court refused to grant class action status to respondents' Exchange Act claims. *Sanders*, 634 F.Supp. at 1061-63 (App. D-23 to 27).

The District Court also ruled that the mere possibility that each member of the class might have to prove his or her individual reliance constituted a *per se* bar to class certification. *Sanders*, 634 F.Supp. at 1061, 1063 (App. D-23, 27). The District Court, therefore, focused its inquiry on whether reliance may be presumed under the "fraud on the market" theory adopted in *Shores v. Sklar*, 647 F.2d 462 (5th Cir. 1981) (*en banc*), *cert. denied*, 459 U.S. 1102 (1983). Ignoring numerous paragraphs of respondents' Complaint which contain this *precise* allegation, the District Court held that respondents "*do not*

*allege* that the securities would not have been sold had the misrepresentations not been present"—a necessary predicate to the *Shores* presumption. *Sanders*, 634 F.Supp. at 1063 (App. D-28) (emphasis added). Based on this and its other findings, the District Court denied class certification.

Respondents filed a timely motion for reconsideration which, in an order dated July 8, 1986, the District Court also denied. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,267 (App. Exhibit E). As they had done previously, respondents pointed out, in their motion for reconsideration, that they had, indeed, clearly and unambiguously alleged in their Complaint that "but for" the presence of the misrepresentations and omissions, the partnership interests could not have been sold. Apparently mindful of its previous erroneous ruling on this issue, the District Court, in its July 8th order, shifted its analysis to an evaluation of the "support" for that allegation. The District Court conducted a selective analysis of what it considered to be the "evidence" for that allegation and determined that it was insufficient to support the theory. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 94,271-72 (App. E-9 to 11). However, the District Court specifically found that the issue of class certification involved several controlling questions of law about which substantial grounds existed for differences of opinion and that an immediate appeal from its two orders would materially advance the ultimate termination of the litigation. *Sanders*, [1986-87 Transfer Binder] ¶ 92,880 at 92,274-75 (App. E-17 to 19). Accordingly, the District Court certified the class issue for interlocutory appeal pursuant to 28 U.S.C. § 1292(b) (1982). The Eleventh Circuit Court of Appeals accepted the appeal in an order dated August 21, 1986 (App. Exhibit F).

In a unanimous opinion, the Court of Appeals reversed the denial of class certification with respect to respondents' federal securities law claims. The Court of Appeals ruled that the District Court had erred in refusing to give any consideration whatsoever to possible class treatment of respondents' claims under Sections 11 and 12(2) of the Securities Act. *Kirkpatrick*, 827 F.2d at 725-26 (App. A-12 to 13).

Turning to respondents' Section 10(b) and Rule 10b-5 claims, the Court of Appeals observed that the District Court's entire analysis of the "predominance" issue was "based directly on [its] interpretation of the substance of the plaintiffs' claims." *Kirkpatrick*, 827 F.2d at 721 (App. A-4). Accordingly, the Eleventh Circuit reviewed respondents' Complaint to determine whether the District Court had properly construed those claims. The Court of Appeals concluded that the District Court had not. The Eleventh Circuit unanimously held that the District Court had "mischaracterized" the case as one involving "primarily individualized oral representations rather than a common scheme by the defendants toward the plaintiff purchasers." *Kirkpatrick*, 827 F.2d at 722, 725 (App. A-6, 11). Having placed the case in its proper context, the Court of Appeals carefully reviewed the entire record in the case, and determined that the "predominance" requirement of Rule 23(b)(3) was easily satisfied. *Kirkpatrick*, 827 F.2d at 724 (App. A-10). The Eleventh Circuit, following a long and unbroken line of authority, held that "[i]n view of the overwhelming number of common factual and legal issues presented by plaintiffs' misrepresentation claims, . . . the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment." *Kirkpatrick*, 827 F.2d at 724-25 (App. A-11). The Eleventh Circuit also held that the case fell squarely within the principles announced in *Shores v. Sklar*, and that respondents were entitled to a presumption of reliance afforded by the "fraud on the market" theory recognized in that case. In so doing, the Court of Appeals ruled that the District Court could not, as it had done, base its findings on class certification "*upon nothing other*" than the District Court's assessment of the likelihood of success on the merits of respondents' claims. *Kirkpatrick*, 827 F.2d at 723 (App. A-7)(emphasis added).

Having corrected the numerous legal and factual errors which plagued the District Court's orders, the Court of Appeals remanded the class issue to the District Court for application of the correct standards. *Kirkpatrick*, 827 F.2d at 720, 728 (App. A-2, 17).

## SUMMARY OF ARGUMENT

The issues raised in the Petition present no novel or unique questions of constitutional or statutory interpretation worthy of review by this Court. The decision of the Court of Appeals is firmly rooted in the precedents of this Court, follows a long and unbroken line of authority in the Eleventh Circuit, and is fully consistent with the case law in other Circuits. The alleged "conflict" which petitioner strives to create is nonexistent.

## REASONS FOR DENYING THE PETITION

### I.

### THE ISSUES RAISED IN THE PETITION ARE NOT RIPE FOR DETERMINATION WITH RESPECT TO ALL OF THE QUESTIONS PRESENTED FOR REVIEW

The Court of Appeals neither granted nor denied class certification. Rather, the Eleventh Circuit remanded the class issue to the District Court for further proceedings consistent with its decision. Thus, the class motion remains undecided. Under these circumstances, it is unnecessary for this Court to exercise its certiorari jurisdiction at this time to render what essentially would be an advisory opinion.

In *Brotherhood of Locomotive Firemen and Enginemen v. Bangor & Aroostook R.R. Co.*, 389 U.S. 327 (1967), the Court denied a petition for writ of certiorari where the court of appeals had remanded the case to the district court for further proceedings. In *Brotherhood*, the district court had issued a temporary restraining order against a union prohibiting a strike. The union nevertheless went on strike, and the district court entered contempt orders, imposing substantial fines for alleged violations of its restraining order. On appeal, the court of appeals ruled on many of the legal issues presented to it, but remanded the case to the district court to determine whether there had been substantial compliance with the restraining order and, if not, whether any such violation of the order had been deliberate and flagrant. *Bangor & Aroostook R.R. Co. v. Brotherhood of Locomotive Firemen and Enginemen*, 380 F.2d

570 (D.C.Cir. 1967). The union sought certiorari to review the adverse rulings made by the court of appeals. This Court, noting that the court of appeals had remanded the case, held the issues were "not yet ripe for review by this Court," and denied the petition. 389 U.S. at 328.

Just as the court of appeals in *Brotherhood* did not make findings on critical issues but, rather, remanded the case to the district court for further proceedings, so the Eleventh Circuit here did not certify a plaintiff class but, rather, remanded the case to the District Court for further findings. The issues involved in this case, as in *Brotherhood*, simply are "not yet ripe for review."

There is no particular exigency which would attend the denial of certiorari in this case. Petitioner will be free to challenge, as part of the normal appellate process after final judgment, any class which the District Court ultimately might certify in this case. In the interim, numerous developments might occur which could significantly alter or entirely moot the issues raised in the Petition. For example, the District Court might certify a class different from the class pleaded in respondents' Complaint or refuse to certify the Securities Act claims. The District Court also may subsequently alter or amend any certification order which it might enter in this case. *See* Fed.R.Civ.P. 23(c)(1) (district court retains authority to alter or amend a class order until "a decision on the merits"). The jury may return a verdict in favor of petitioner on the merits of respondents' claims, thereby effectively mooting all of the issues raised in the Petition. Petitioner has stretched the truth in its attempt to convince this Court to exercise its jurisdiction in this case at this time. A perfect example is petitioner's argument with respect to the Eleventh Circuit's handling of the adequacy of respondents as class representatives. Petitioner claims:

> The District Court expressly found, and the Court of Appeals did not question, that respondents would not adequately represent the interests of other class members . . . .

(Petition, p. 17). In fact, the Eleventh Circuit found that the District Court had applied an incorrect standard in determining the "adequacy" requirement of Rule 23(a)(4) (App. A-17). The Eleventh Circuit specifically refused to conduct an independent application of the correct standard in this case but remanded to the District Court for a factual determination using the correct legal standard—a standard which is virtually identical to that adopted in every other circuit.

Exercise by this Court of jurisdiction at this time is inappropriate. The issues simply are entirely too distant and speculative to warrant review at this time.

As the Court held almost a century ago in *American Construction Co. v. Jacksonville, Tampa & Key West Ry. Co.*, 148 U.S. 372 (1893):

> Whether an interlocutory order may be separately reviewed by the appellate court in the progress of the suit, or only after and together with the final decree, is matter of procedure rather than of substantive right; and *many orders made in the progress of a suit become quite unimportant by reason of the final result or of intervening matters.* Clearly, therefore, *this court should not issue a writ of certiorari to review a decree of the circuit court of appeals on appeal from an interlocutory order, unless it is necessary to prevent extraordinary inconvenience and embarrassment in the conduct of the cause.*

*Id.* at 384 (emphasis added). The Court reaffirmed these principles two decades later in *Hamilton-Brown Shoe Co. v. Wolf Bros. & Co.*, 240 U.S. 251 (1916), when it stated:

> [Certiorari] is a jurisdiction to be exercised sparingly, and only in cases of peculiar gravity and general importance, or in order to secure uniformity of decision .... *And except in extraordinary cases, the writ is not issued until final decree* .... The decree that was sought to be reviewed by certiorari at complainant's instance *was not a final one, a fact that of itself alone furnished sufficient ground for the denial of the application.* ...

*Id.* at 258 (emphasis added)(citations omitted). *See also* Supreme Court Rule 17.1. Here, review of the class issue should await not just a ruling on the class motion itself, but final judgment in this case.

There is another, equally compelling, reason for denying the Petition. The centerpiece of petitioner's argument unquestionably is its frontal assault on the "fraud on the market" theory enunciated in *Shores v. Sklar.* While that theory may have some bearing on some of respondents' claims, it is undisputed that the "fraud on the market" theory is not implicated at all with respect to several of respondents' other claims. For example, the Court of Appeals ruled that the District Court "improperly found that the plaintiffs' Rule 10b-5(2) misrepresentation claims were not suited for class treatment." *Kirkpatrick*, 827 F.2d at 724 (App. A-10). In so doing, the Court of Appeals held that "the mere presence of the factual issue of individual reliance could not render the claims unsuitable for class treatment." *Kirkpatrick*, 827 F.2d at 724-25 (App. A-11).[4] Thus, respondents need not rely on the presumption of reliance afforded by the "fraud on the market"

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[4] This principle has received such widespread and uniform acceptance by the Circuits that it is no longer subject to serious dispute. *See, e.g., Eisenberg v. Gagnon*, 766 F.2d 770, 786 (3d Cir.), *cert. denied*, 106 S.Ct. 342 (1985); *Blackie v. Barrack*, 524 F.2d 891, 902 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976); *Green v. Wolf Corp.*, 406 F.2d 291, 301 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). As the Second Circuit observed in *Green:*

> Wolf earnestly argues that each person injured must show that he personally relied on the misrepresentations in order to recover and thus any common issues of misrepresentations do not predominate over the individual questions of reliance. Even if Wolf is correct in its assertion of the need for proof of reliance, and we express no views on that issue, we must still reject the argument. Carried to its logical end, it would negate any attempted class action under Rule 10b-5, since as the District Courts have recognized, reliance is an issue lurking in every 10b-5 action.

406 F.2d at 301. *Accord, In re Home-Stake Production Co. Securities Litigation*, 76 F.R.D. 351, 372 (N.D. Okla. 1977); *Sharp v. Coopers & Lybrand*, 70 F.R.D. 544, 547-48 (E.D. Pa. 1976); *Vernon J. Rockler v. Graphic Enterprises, Inc.*, 52 F.R.D. 355, 345-46 (D. Minn. 1971).

theory for class certification of their Rule 10b-5(2) misrepresentation claims.

In summary, the District Court, on remand, must reconsider the issue of class certification irrespective of the outcome of the issues raised in the Petition. Under these circumstances, granting the writ will serve merely to delay the resolution of this case without any concomitant contribution to the preservation of judicial resources. To the contrary, the judicial process will be ill-served by such piecemeal, fragmented litigation.

## II.

## THE DECISION OF THE COURT OF APPEALS IS FIRMLY ROOTED IN WELL-SETTLED PRINCIPLES OF LAW AND PROCEDURE AND IS FULLY CONSISTENT WITH EXISTING PRECEDENT

The Court of Appeals—far from according blind deference to respondents' Complaint, as petitioner suggests—merely held that the District Court could not disregard respondents' Complaint in its entirety and unilaterally reformulate respondents' case in a manner which they neither pleaded nor intended to prove. The Eleventh Circuit adopted a view of the case which *the District Court itself* had adopted in analyzing the "commonality" and "typicality" requirements of Rule 23—one grounded on a common course of fraudulent conduct which affected each member of the class in the same manner, and involving widely distributed uniform written material. The Court of Appeals held that the evidence presented both prior to and during the class certification hearing, *viewed in its proper context,* supported certification of the Section 10(b) and Rule 10b-5 claims. The Court of Appeals' decision is legally correct, factually sound, and does not merit review by this Court. One need only read respondents' Complaint (something which the District Court stated it was not required to do) to reach the same conclusion.

Petitioner has only itself to blame for misleading the District Court through its persistent mischaracterizations of respondents' case. Such tactics frequently are employed by

those who would deny any relief to a class of defrauded investors. Typical is *Shankroff v. Advest, Inc.*, 112 F.R.D. 190 (S.D.N.Y. 1986), a case involving another brokerage firm which sold the Petro-Lewis partnerships. The *Shankroff* court rejected the brokerage firm's attempt, like petitioner here, to mischaracterize the issues as highly individual in nature. The court held that the complaint alleged that the brokerage firm engaged in a course of conduct designed to encourage investment in Petro-Lewis while failing to disclose the "deplorable" financial condition of Petro-Lewis. 112 F.R.D. at 193. *Accord, In re Baldwin-United Corporation Litigation*, MDL No. 581, M 21-35 (CLB) (S.D.N.Y., June 27, 1986 Memorandum Decision Granting Class Certification (a copy of which is appended hereto as Respondents' Appendix A)).

As the Eleventh Circuit specifically found, the focus of this case is on the prospectuses and other written material distributed to members of the class and on the fraudulent conduct of petitioner's senior management, *not* on any ancillary oral statements made by individual brokers employed by petitioner to their clients.[5] Under such circumstances, courts have uniformly held that mere presence of oral statements will not render individual questions of reliance predominant over the common issues of fraud and materiality. *See, e.g., Kennedy v. Tallant*, 710 F.2d 711, 717-18 (11th Cir. 1983)("The substance of the oral representations made by the various salesmen is not an issue in this suit."); *Esplin v. Hirschi*, 402 F.2d 94, 97 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969) ("undoubtedly the possibility exists that there will be questions of individual oral misrepresentations to each of the potential plaintiffs," but "having alleged . . . that there was omissions and half truths common to all purchasers . . . it is apparent that the issue of liability . . . was to be the same as to all purchasers"); *Arthur Young & Co. v. United States District Court*, 549 F.2d 686, 695

[5] The Eleventh Circuit also specifically found that the record in this case was devoid of any evidence that class members were even exposed to differing oral communications, let alone that any such communications "varied materially from the misleading information alleged to have been disseminated generally as a result of the defendants' common schemes." *Kirkpatrick*, 827 F.2d at 724 (App. A-10). This is uncontroverted.

(9th Cir.) *cert. denied,* 434 U.S. 829 (1977) (alleged reliance on oral statements was of "questionable evidentiary significance for purposes of making a Rule 23 determination" in cases involving primarily written misrepresentations); *Eisenberg v. Gagnon,* 766 F.2d 770, 786 (3d Cir.), *cert. denied,* 106 S.Ct. 342 (1985) (denial of class certification under similar facts was an "abuse of discretion"); *In re Home-Stake Production Co. Securities Litigation,* 76 F.R.D. 351, 369-73 (N.D. Okla. 1977) (possible variations in oral statements made to limited partners in oil and gas investment programs did not defeat class certification when a fraudulent prospectus was also the basis of plaintiff's claim).

These courts have adopted a common-sense approach, and recognize that it is a rare securities transaction which is not accompanied by some type of oral communication between an investor and his or her broker. Adoption of a *per se* bar to class certification whenever a securities transaction involves oral communications—the very position advocated by petitioner and adopted by the District Court here—would totally eviscerate the class action device in the securities context. It is undoubtedly for this reason that the courts have consistently rejected such an approach, and that the Eleventh Circuit recognized in this case that respondents' claims "essentially involve allegations that the defendants 'committed the same unlawful acts in the same method against the entire class.'" (App. A-10) (citations omitted).

In this connection, petitioner apparently refuses to recognize the difference between "oral representations" and "oral *mis*representations." The former may be entirely consistent with the written materials and their mere presence in a case, as the Eleventh Circuit found here and as the cases cited previously uniformly hold, will not defeat certification. Oral *mis*representations, by contrast, may give rise to liability under the federal securities laws, and present a problematic situation for class certification, *if—but only if—the class' claims are grounded on those oral misstatements.* In those types of cases, the plaintiff must come forward with evidence of a standardized sales pitch in order to satisfy the requisite "commonality" and "predominance" elements of Rule 23. That is not *this* case.

## III.

## THE DECISION OF THE COURT OF APPEALS FALLS SQUARELY WITHIN THE HOLDING OF *SHORES v. SKLAR* AND THE UNBROKEN LINE OF AUTHORITY WHICH HAS FOLLOWED IN ITS WAKE

The Court of Appeals correctly held, as has every other court which addressed the issue,[6] that a plaintiff alleging fraud under Rule 10b-5 may, in circumstances where it is alleged that securities could not have been marketed "but for" the fraud, invoke a rebuttable presumption of reliance upon the integrity of the marketplace. *Kirkpatrick*, 827 F.2d at 722-23 (App. A-6 to 7), citing *Shores v. Sklar, supra.*[7] The fraud on the market theory as enunciated by the Eleventh Circuit is consistent with other circuits and clearly furthers the purposes of the securities laws. As this Court held in *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976), the securities acts were designed to protect investors against fraud and to promote ethical standards of honesty and fair dealing.

Reliance is generally part of the logical chain needed to establish an element of a 10b-5 claim: that a defendant's misrepresentation or omission in fact caused the plaintiff's injury. *See List v Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965). Although the requirement is easily met by showing the plaintiff's actual subjective reliance on the defendant's misstatement (*see* 3 L.

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[6] *See, e.g., T.J. Raney & Sons, Inc. v. Fort Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330, 1333 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Shores v. Sklar, supra; Arthur Young & Co. v. United States District Court*, 549 F.2d 686, 695 (9th Cir.), *cert. denied*, 434 U.S. 829 (1977); *Rose v. Arkansas Valley Environmental & Utility Authority*, 562 F.Supp. 1180, 1201-03 (W.D. Mo. 1983); *Frankel v. Wyllie & Thornhill, Inc.*, 537 F.Supp. 730, 735-37 (W.D. Va. 1982); *Dekro v. Stern Bros. & Co.*, 540 F.Supp. 406, 410-11 (W.D. Mo. 1982). *See also* Note, *Fraud on the Market—An Emerging Theory Of Recovery Under SEC Rule 10b-5*, 50 Geo. Wash. L. Rev. 627, 645-55 (1982).

[7] The Eleventh Circuit, in the *en banc* decision *Bonner v. City of Prichard*, 661 F.2d 1206 (11th Cir. 1981), adopted as precedent the decisions of the former Fifth Circuit, including *Shores*, rendered prior to October 1, 1981.

Loss, *Securities Regulation*, at 1430-32 (2d ed. 1961)), courts have held that proof of such direct reliance is not necessary in certain cases, including those alleging a *Shores*-type "fraud on the market."

The "fraud on the market" theory recognized in *Shores* (and reaffirmed by the Eleventh Circuit here) is grounded on the premise that "[t]he securities laws allow an investor to rely on the integrity of the market to the extent that the securities it offers to him for purchase are entitled to be in the marketplace." *Shores*, 647 F.2d at 471. Under *Shores*, the requisite causation is provided by proof that "securities not traded on the open market could not have been issued but for a fraudulent scheme by the defendants." *Kirkpatrick*, 827 F.2d at 722 (App. A-7), *citing Shores*, 647 F.2d at 469. Allegations to that effect allow a rebuttable presumption that investors who purchased the securities and relied on the integrity of the market were harmed by the defendant's fraud.

The logic underlying the theory is manifest. If securities could not have been marketed but for a fraudulent scheme, it follows that an investor satisfies the requisite causal link by evidence that he or she purchased the securities in reliance, in whole or in part, on the integrity of the market. Indeed, as the Eleventh Circuit noted here, recognition of the "fraud on the market" theory is as compelling in a *Shores*-type case as it is in a so-called "open market" [8] context:

> A *Shores* fraud-on-the-market claim thus is especially suited for class action treatment, as it makes virtually

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[8] See *Basic Inc. v. Levinson*, 107 S.Ct. 1284 (1987), *granting cert. to*, 786 F.2d 741 (6th Cir. 1986). *See also Peil v. Speiser*, 806 F.2d 1154 (3d Cir. 1986); *Harris v. Union Electric Co.*, 787 F.2d 355, 367 & n. 9 (8th Cir. 1986), *cert. denied*, No. 85-2036 (Oct. 6, 1986); *Lipton v. Documation, Inc.*, 734 F.2d 740 (11th Cir. 1984), *cert. denied*, 469 U.S. 132 (1985); *T.J. Raney & Sons, Inc. v. Fort Cobb Oklahoma Irrigation Fuel Authority*, 717 F.2d 1330 (10th Cir. 1983), *cert. denied*, 465 U.S. 1026 (1984); *Panzirer v. Wolf*, 663 F.2d 365 (2d Cir. 1981), *vacated as moot after cert. granted*, 459 U.S. 1027 (1982); *Ross v. A.H. Robins Co.*, 607 F.2d 545, 553 (2d Cir. 1979), *cert. denied*, 446 U.S. 946 (1980); *Blackie v. Barrack*, 524 F.2d 891 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976).

> irrelevant the possibility that the various purchasers may have relied on different representations regarding the desirability of the particular security in question; all have relied on the integrity of the market in the but-for sense required by *Shores*.

*Kirkpatrick*, 827 F.2d at 718 (App. A-9)(footnote omitted). A similar view was expressed by the Ninth Circuit in *Arthur Young & Co. v. United States District Court, supra*, when it observed:

> Just as the open market purchaser relies on the integrity of the market and the price of the security traded on the open market to reflect the true value of securities in which he invests, so the purchaser of an original issue security relies, at least indirectly, on the integrity of the regulatory process and the truth of any representations made to the appropriate agencies and the investors at the time of the original issue.

549 F.2d at 695.

Courts have similarly accepted the common-sense observation that most investors rely on the integrity of the market in making trading decisions. As one court has observed: "It is hard to imagine that there ever is a buyer or seller who does not rely on market integrity. Who would knowingly roll the dice in a crooked crap game?" *Schlanger v. Four-Phase Systems, Inc.*, 555 F.Supp. 535, 538 (S.D.N.Y. 1982). The fact that persons invest in the market at all is evidence that they rely on the assumption "that the market is not being manipulated as a result of anybody's false statement or misleading omission." *Id.*

Respondents clearly alleged that the Petro-Lewis securities could not have been marketed "but for" the fraudulent scheme, and respondents came forward with uncontroverted evidence that they relied on the integrity of the market when they made their purchases. No more is required at the class certification stage.

Where, as here, material information is *not* "fully disclosed," investors are *not* "told the truth" about the security and, because of the foregoing, investors are *not* able to make an

"informed" investment decision, liability should and does attach under Rule 10b-5. If those same investors are successful in proving at trial that full and complete disclosure of all material information would have prevented the securities from being sold in the first place (i.e., rendered them "unmarketable"), and that petitioner participated in a scheme to suppress that information, the investors have proven a violation of Rule 10b-5(1) and (3). *See Shores*, 649 F.2d at 468-69. Among the items of evidence in this case, for example, which will be offered at trial are that critical parties to the offerings would not have participated in the syndications had the truth been known about the investments, and that insufficient funds would have been raised from subscriptions to purchase the oil reserves which constituted the partnership assets. Just as fraud can interfere with the market's pricing mechanism, it can also disrupt the issuance of "new" securities.

Critics of the *Shores* decision—including petitioner here—refer to disclaimers issued by the SEC that warn investors not to rely on the qualitative soundness of any security. This position miscontrues the remedial nature of the federal securities laws and is in conflict with the securities acts' objectives of full disclosure and investor protection. Although the SEC does not guarantee or pass judgment upon the qualitative soundness of particular securities, it would be fallacious to assume that investors are left unprotected against fraud in the issuance of those securities. The purpose of the SEC's disclaimers is to insulate the Commission against civil liability from disgruntled investors who have made poor investment decisions. Permitting an injured investor to compel the wrongdoer to compensate for the investor's losses does not interfere with that purpose and therefore should not be precluded by the disclaimers. *See* Note, *Fraud On The Market—An Emerging Theory of Recovery Under SEC Rule 10b-5*, 50 Geo. Wash. L. Rev. 627, 652-53 (1982).

Petitioner engages in a specious argument in its attempt to convince this Court that the decision of the Eleventh Circuit conflicts with other jurisdictions. Petitioner claims that the Eleventh Circuit, through the use of the terms "fraudulently marketed" at one point in its opinion, has changed the require-

ments for a *Shores*-type "fraud on the market" claim. (Petition, p. 11-12). Petitioner ignores the clear statement of the Eleventh Circuit:

> Because the Petro-Lewis shares were not traded on the open market, we need not now consider the appropriateness of class certification of traditional fraud-on-the-market claims involving securities that are openly traded. We concluded however, that where as here, a complaint alleges that a security not traded on the open market could not have been issued but for the fraud of the defendants, class action treatment is not precluded by the possibility that some purchasers, including the named plaintiffs, might have relied on factors other than the integrity of the market. (App. A-8).

Despite petitioner's misstatement of the Eleventh Circuit's decision, the opinion of the Eleventh Circuit is squarely on point with all other circuits which have considered the issue.

## CONCLUSION

For the foregoing reasons, the Petition for Writ of Certiorari to review the decision of the United States Court of Appeals for the Eleventh Circuit should be denied.

Dated: Atlanta, Georgia
January 6, 1988

Respectfully submitted,

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APPENDIX A

# UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

IN RE BALDWIN-UNITED CORPORATION LITIGATION

MDL 581
M 21-35 (CLB)

MEMORANDUM DECISION
[Class Certification]

This Document Relates To:

ALFRED LINTON and JEROME W. EICHELSBACHER,
*Plaintiffs,*

-against-

SHEARSON LEHMAN/AMERICAN EXPRESS, INC., *et al.*,
*Defendants.*

83 Civ. 8476 (CLB)

VINCENT ERTI, *et al.*,
*Plaintiffs,*

-against-

PAINEWEBBER JACKSON & CURTIS, INC., *et al.*,
*Defendants.*

83 Civ. 9085 (CLB)

*(caption continues)*

*(caption continued)*

OSCAR J. WOODS,
*Plaintiff,*

-against-

W.H. NEWBOLD'S SONS & CO., INC., *et al.*
*Defendants.*

84 Civ. 2235 (CLB)

STEVEN A. PEREL,
*Plaintiff,*

-against-

ROTAN MOSLE, INC., *et al.*,
*Defendants.*

84 Civ. 8879 (CLB)

**Brieant, J.**

By motion fully argued and submitted on March 7, 1986, plaintiffs in this multidistrict litigation seek class certification pursuant to Rule 23, F.R.Civ.P., in each of the above-captioned four actions, which have been consolidated in this Court by transfer orders on the Judicial Panel on Multidistrict Litigation. Familiarity of the reader with all prior proceedings in this litigation is assumed, although the Court directs special attention to its decision *In Re Baldwin-United Corp.*, 105 F.R.D. 475 (S.D.N.Y. 1984), in which the Court certified tentative classes in fourteen related cases against different defendants on similar claims, for the purpose of settlement. Subsequently, a total of twenty-four consolidated class actions against that many broker-dealer defendants in the Baldwin-United securities litigation were certified and each was settled.

Plaintiffs in these four remaining actions allege that the defendant broker-dealers and Planco, Inc. engaged in a common course of fraudulent conduct in omitting material information in connection with their sales of certain investment contracts to the plaintiffs. These contracts, known as single

premium deferred annuities (SPDAs), were issued from 1979 to 1983 by two insurance subsidiaries of Baldwin-United and were marketed to the public nationwide by various means, including sale through broker-dealers such as the defendants in these four actions. In 1983, the two issuing insurance companies and four other subsidiaries that reinsured the SPDAs were placed in rehabilitation, and the parent corporation, Baldwin-United, entered bankruptcy. Thereafter, SPDA purchasers, including the class plaintiffs herein, commenced the federal civil actions that eventually were consolidated into this multidistrict litigation.

Jurisdiction is conferred over the federal law claims by Section 22 of the Securities Act of 1933 ("1933 Act"), 15 U.S.C. § 77(v), Section 27 of the Securities Exchange Act of 1934 ("1934 Act"), 15 U.S.C. § 78aa, and Section 4 of the Racketeer Influenced and Corrupt Organizations Act ("RICO"), 18 U.S.C. § 1964. The Court is likewise empowered to hear the state statutory and common law claims pleaded by virtue of diversity of citizenship and under principles of pendent jurisdiction.

The amended consolidated complaints in the *Linton*, *Erti* and *Woods* actions and the complaint in *Perel* each recite nine separately denominated claims for relief alleging violations of Sections 5, 12(1) of the Act, 15 U.S.C. § 78j(b) and Rule 10b-5 promulgated thereunder, and Section 1962(c) of RICO, as well as common law fraud and deceit and violations of state securities, consumer and fiduciary responsibility laws. The plaintiffs also assert claims premised on common law negligence, breach of contract and breach of fiduciary duty against all defendants except Planco, Inc. ("Planco"). Except for variations in the pleadings to account for facts peculiar to each plaintiff, the complaints are identical in all respects pertinent to these class certification motions. Therefore, the Court will not distinguish among them when examining their suitability for class certification, except as may be required to consider specific, fact-oriented arguments raised by a particular broker-dealer that call for individualized analysis.

**Numerosity**

In order to qualify for class action treatment, plaintiff must demonstrate that each of the four prerequisites set forth in Rule 23(a) has been satisfied and, in addition, that at least one of the factors described in Rule 23(b) is present. The first requirement, that the classes be so numerous that joinder of all the aggrieved individuals would be impracticable, is not contested here. Over several years, each broker-dealer sold SPDAs having an aggregate face value well in excess of a million dollars to purchasers throughout the country. The identity and exact number of prospective class members are ascertainable from defendants' records and those of the state rehabilitators of the issuers, and it is reasonable to conclude in view of the magnitude of this marketing effort that the number of affected persons would justify class certification.

**Commonality**

The second requirement, commonality, is more problematic. Under Rule 23(a)(2), plaintiffs must show that common questions of law and fact susceptible to class treatment predominate among the putative class members' claims. The gravamen of plaintiffs' complaints is that the defendants, in connection with their business of analyzing investment opportunities and providing financial services to clients, each engaged in a similar unified course of conduct to promote and sell Baldwin-United's SPDAs to the public without disclosing that the issuer was experiencing financial and regulatory difficulties. Plaintiffs contend that the defendants, at the corporate, policy making level, knew or recklessly disregarded evidence of Baldwin-United's precarious financial condition and that they elected to implement or maintain standardized marketing practices that concealed the true investment risks of the SPDAs. Those practices, plaintiffs allege, emphasized the safety, liquidity and promising investment aspects of the SPDAs even though information available to the defendants foretold Baldwin-United's collapse. Plaintiffs contend that the defendants' failure to investigate and ascertain the solidity of the SPDAs' financial backing, their practice of using uniformly deceptive promotional materials to solicit purchases, and their

failure or refusal to disclose the material omissions and half-truths embodied in their marketing strategy together caused SPDA holders to sustain substantial injury when their investments deteriorated.

The broker-dealers, for their part, deny that common issues of law and fact predominate. They maintain that the core issues submitted by plaintiffs in their complaints turn largely on oral rather than written representations, or on non-uniform documents that will require greater investigation and analysis of individual facts than class treatment will allow. For example, defendants assert, the threshold issue—whether the SPDAs are in fact securities—invites inquiry into the manner in which the SPDAs were sold and how they were described to prospective investors. Similarly, allegations of statutory and common law fraud would require the Court to make findings as to the parties' state of mind, the information disclosed, and also the fluctuating fortunes of Baldwin as of the time a particular investor made his or her purchase. The defendants therefore conclude that the highly individualized character of these transactions, affecting some 50,000 investors, makes class certification inappropriate.

This Court disagrees. The nub of plaintiffs' claims is that material information was withheld from the entire putative class in each action, either by written or oral communication. Essentially, this is a course of conduct case, which as pled satisfies the commonality requirement of Rule 23, F.R.Civ.P. *See, Green* v. *Wolf Corp.*, 406 F.2d 291, 300 (2d Cir. 1968), *cert. denied*, 395 U.S. 977 (1969). Although their circumstances may vary slightly, the class members are united in attempting to establish the defendants' liability for fraudulently creating an illusion of profitability and a false sense of security when the undisclosed facts suggest otherwise. The fact that the Planco marketing brochures may have varied slightly from broker to broker and customer to customer is not controlling here. Plaintiffs allege not that the promotional materials themselves were uniform, but rather that the information they contained—and hence that the broker-dealers disseminated—was uniformly misleading. Thus, at the very outset, the common issue of fact uniting all SPDA purchasers is

whether the Planco sales literature to which they were exposed was distorted by identical half-truths and omissions that materially affected their investment decisions. Following closely are common questions of the broker-dealers' own culpability in utilizing these materials and in failing to detect and disclose information that would have revealed the SPDAs' shaky foundations. Liability in this case does not depend on proof of the individual, face-to-face dealings between the class members and the registered representatives of the broker-dealers, and slight differences in the class members' positions will not defeat their common status as alleged victims of similar misrepresentations. *See Blackie* v. *Barrack*, 524 F.2d 801, 902 (9th Cir. 1975), *cert. denied*, 429 U.S. 816 (1976). The wrongful conduct alleged by plaintiffs occurred at the management level, if it did, and manifested itself in the defendants' course of promoting and selling the SPDAs. As a result, the relevant questions are readily susceptible to class-wide proof.

Indeed, inquiries into the actual sales process are of secondary importance. Plaintiffs are not required to establish how each and every SPDA was sold in order to prove that the SPDAs were securities. Similarly, it is not fatal to class certification that a particular investor did not receive or rely upon the contents of a Planco brochure. In a case such as this where liability would rest primarily on a failure to disclose material facts, positive proof of reliance is not a prerequisite to recovery. *Affiliated Ute Citizens* v. *United States*, 406 U.S. 128, 153-54 (1972). Similarly, the presence of oral representations or embellishments proffered by an account representative will not rend this class, even if they were the sole basis for an individual's decision to purchase an SPDA. Unlike *In Re Scientific Control Corp. Securities Ltd.*, 71 F.R.D. 491 (S.D.N.Y. 1979), and other cases where claims based on oral representations were denied class status, in this case the representations related to objective factors—the issuer's financial stability or the safety, yield and liquidity of the SPDAs—that originated from a common source: the Planco documents or the broker-dealers' alleged refusal to conduct their own investigations. *See Korn* v. *Franchard Corporation*, 456 F.2d 1206, 1212 (2d Cir. 1972). Even proof of a material variance

among the representations will not defeat the class if certain omissions, inferred from their absence in the Planco literature, were common to all. *See Esplin* v. *Hirschi*, 402 F.2d 94, 99-100 (10th Cir. 1968), *cert. denied*, 394 U.S. 928 (1969).

The defendants also argue that individual questions relating to the timeliness of certain securities claims predominate over any common issues that may exist. The Court disagrees. Camouflaged as an attack on commonality, this argument in fact invites the Court to examine and accept in the course of these class certification motions an affirmative defense that is potentially dispositive of several claims in this litigation. Such inquiry is outside the scope of Rule 23 and indeed defies the principle enunciated in *Eisen* v. *Carlisle & Jacquelin*, 417 U.S. 156 (1974), that a court may not review the substantive issues raised in a class complaint when determining the claims' suitability for class treatment. *See, e.g., Chevalier* v. *Baird Savings Association*, 72 F.R.D. 140, 150 (E.D. Pa. 1976); *see also Mersay* v. *First Republic Corporation of America*, 43 F.R.D. 465, 471 (S.D.N.Y. 1968) (class certified notwithstanding individual questions as to statute of limitations).

Accordingly, the Court concludes that common issues of fact predominate in these actions and that the requirements of Rule 23(a)(2) have been satisfied.

**Typicality**

The third prerequisite for maintaining a class action under Rule 23 is that the individual claims advanced by the named plaintiffs are sufficiently typical of those asserted by the class members they purport to represent. Rule 23(a)(3), F.R.Civ.P. As a general rule, a plaintiff's claim meets the typicality requirement if it arises from the same events or course of conduct that gives rise to the claims of other class members and if it is based on evidence and legal theories consistent with the other members' claims. *Dura-Bilt Corporation* v. *Chase Manhattan Corp.*, 89 F.R.D. 87, 99 (S.D.N.Y. 1981). The test, ultimately, is whether the class representative will promote the interests of the class as he protects his own.

Because this inquiry focuses on the nature of the claims asserted, factual differences involving the date, type and manner of the purchase, the investor's perception of the transaction, or even the information furnished to him at the time will not destroy typicality if each class member was the victim of the same material omissions and the same consistent course of conduct. *See Dura-Bilt, supra; Oscar Gruss & Son* v. *Geon Industries, Inc.*, 75 F.R.D. 531, 534-35 (S.D.N.Y. 1977). This is so even though, as the defendants claim, the amount and type of information available to the public changed constantly throughout the class period, and the named plaintiffs supposedly had purchased their SPDAs at a time when Baldwin-United enjoyed good financial health. The lynchpin of plaintiffs' claim is the alleged nondisclosure of material facts relating to Baldwin-United's solvency; whether the named plaintiffs can prove an actionable omission to sustain their claims invites comment on the merits, which is forbidden in the context of this class certification motion. *See Eisen,* 417 U.S. at 178. Moreover, this Court finds that the putative class representatives will have a strong incentive to develop evidence pertaining to the entire class period because their claims rely on proof of a consistent course of conduct that extended beyond the instances of alleged fraud unique to them.

Similarly, the presence of common law issues in these complaints does not destroy typicality, even though the named plaintiffs will be called upon to represent individuals of many different states if a class is certified. Common law fraud substantially includes the 10b-5 claims, and the Court can order separate hearings to resolve the question of damages, if the need arises.

Notwithstanding certain variations in proof among members of the prospective class, the Court finds that the plaintiffs have satisfied the typicality requirement by showing that the same allegedly unlawful conduct affected all members of the prospective class.

**Adequacy of Representation**

Finally, before certifying the named plaintiffs as class representatives, the Court must be convinced that they will fairly and adequately protect the interests of the absent class members. Rule 23(a)(4), F.R.Civ.P. Although it is not necessary that the putative representatives' claims are identical to those of the class, the constraints of due process preclude class certification if the named plaintiffs possess other, potentially conflicting interests that would impair the vigorous prosecution of the class claims. *See Hansberry* v. *Lee*, 311 U.S. 32 (1940). As set forth above, factual differences involving the sales transaction, for example, the type of promotional material used by the various account representatives and the extent to which the purchaser relied on it, will not defeat class certification. Similarly unpersuasive is the argument, also proffered above, that the plaintiffs who purchased their SPDAs early in the class period have no incentive to prove facts relevant to a purported fraud committed on a subsequent purchaser. Nor can there by any question as to the qualifications, industry and commitment of plaintiffs' counsel. All class members stand or fall on the issue whether material information was misrepresented or withheld from SPDA purchasers, and the Court believes that the named plaintiffs will pursue this issue vigorously.

The Court therefore concludes that each of the prerequisites of Rule 23(a) is satisfied. In addition, the Court finds pursuant to Rule 23(b)(3) that questions of law and fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is the superior method of adjudicating this controversy fairly and adequately.

Shearson Lehman argues that arbitration, which is available upon request to each putative class plaintiff in the Shearson Lehman track of cases, is a less expensive, more efficient—and hence superior—alternative to class litigation on certain arbitrable securities claims. Even assuming for the argument that our Court of Appeals' decision in *McMahon* v. *Shearson/American Express, Inc.*, 788 F.2d 94, 96 (2d Cir. 1986), was

wrong, *cf. Dean Witter Reynolds, Inc.* v. *Byrd*, ____ U.S. ____, 105 S.Ct. 1238, 1240 n. 1 (1985), and that Shearson Lehman enjoys, as it claims, an absolute right to compel arbitration pursuant to sales agreements it entered into with its SPDA customers, this Court does not agree that class treatment is perforce inappropriate as to those claims. The fairness and completeness of class litigation, in contrast to the scattered and fairly random solution suggested by individual arbitration, persuades this Court that fraud claims such as these are often best resolved by class action. Not only are interests of consistency, efficiency and completeness served, but there is also the assurance that most if not all potential claimants will be apprised of their rights and of the named plaintiffs' comparatively inexpensive efforts to vindicate them. This Court finds it hard to believe that any class action defendant so situated would prefer separate arbitration of each of thousands of potential claims that might otherwise be decided by class action at far less transactional cost. At least under the circumstances of this case, arbitration cannot be regarded as a serious alternative to the class action, which is so ideally suited to securities fraud claims.

The standards of Rule 23, at once fair and flexible, reaffirm the known truth that for all its pretensions, law is meant to be practical. The willingness of tweny-four sophisticated broker-dealers, advised by experienced counsel, to settle their companion actions for a record $183 million eloquently bespeaks the appropriateness of class certification among those actions that remain.

Accordingly, plaintiffs' motions for class certification in each of the four litigation tracts is granted. Each class shall be composed of those persons and entities (a) who purchased SPDAs (i) that were issued by National Investors Life Insurance Company and University Life Insurance Company of America and/or reinsured by National Investors Pension Insurance Company, Mt. Hood Pension Insurance Company, National Equity Life Insurance Company, and S & H Life Insurance Company, all of which are affiliated with Baldwin-United Corporation, and (ii) that were purchased through the respective broker-dealer defendants in each such action during

the period January 1, 1979 through July 13, 1983, each in his, her or its individual capacity and any and all collective representatives, assigns, heirs, executors, administrators, custodians, predecessors or successors in interest and any other person having any legal or beneficial interest in any of such SPDAs, and (b) who continued to hold such SPDAs on July 13, 1983.

The respective representatives of the Class as to each of the above-captioned actions shall be and hereby are certified to be as follows:

1. *Linton* v. *Shearson Lehman/American Express, Inc., et al.*, 83 Civ. 8476 (CLB), Alfred Linton and Jerome W. Eichelsbacher;

2. *Erti* v. *Paine Webber Jackson & Curtis, Inc., et al.*, 83 Civ. 9085 (CLB), Vincent Erti, Joseph and Elizabeth Chupko, George and Margaret Ledney, William Neil Aicholtz and Janet Aicholtz, and Genevieve Novicky;

3. *Woods* v. *W.H. Newbold's Sons & Co., Inc., et al.*, 84 Civ. 2235 (CLB), Oscar J. Woods; and

4. *Perel* v. *Rotan Mosle, Inc.*, 84 Civ. 8879, Steven A. Perel.

Settle a formal order on notice, which shall declare the classes as hereinbefore set forth and provide for notice and an opportunity to the members of the classes to exclude themselves.

Dated: White Plains, New York
June 27, 1986

/s/ CHARLES L. BRIEANT

Charles L. Brieant
U. S. D. J.